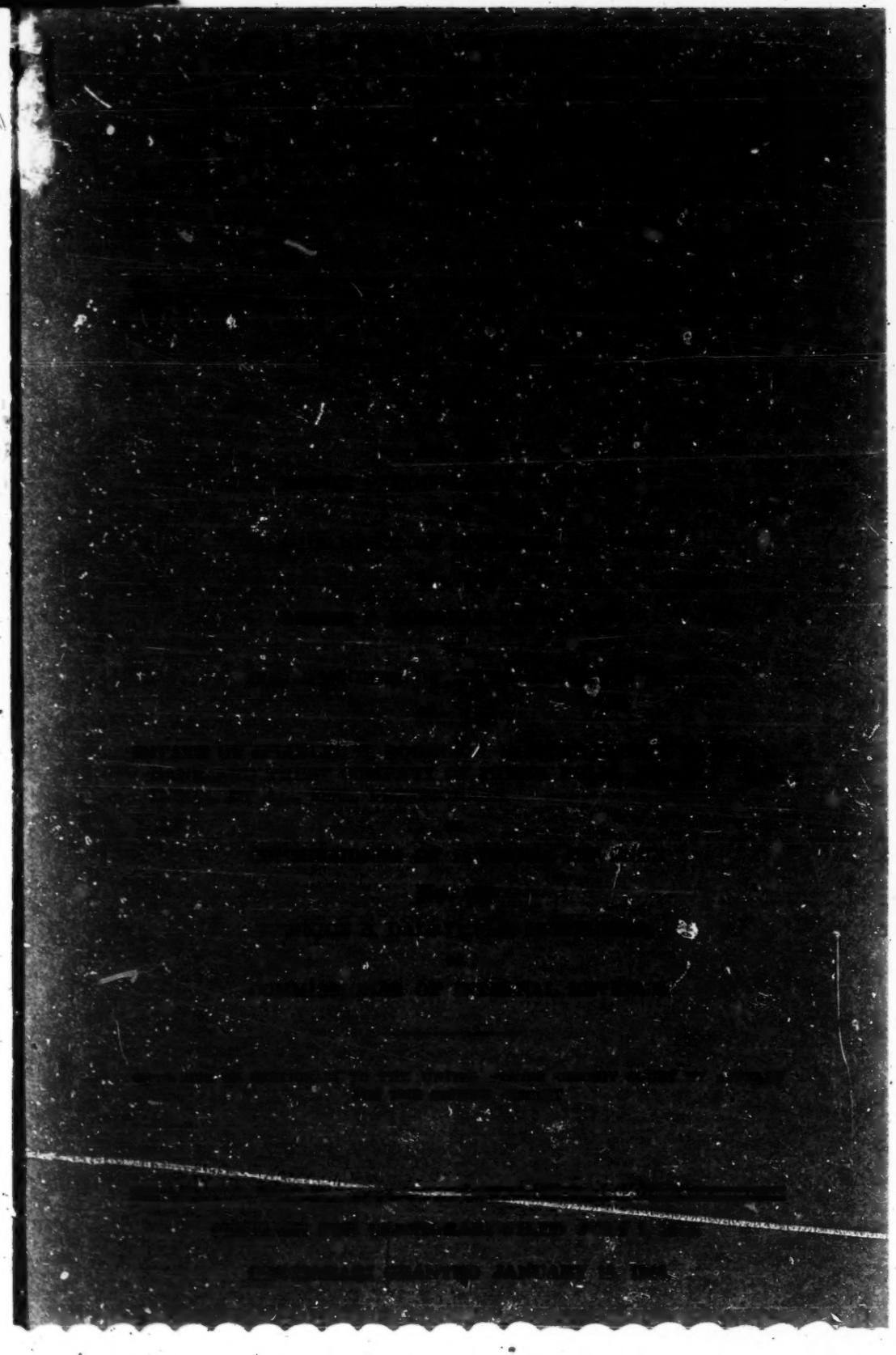

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943

No. 130

BESSIE P. DOUGLAS, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

No. 131

BESSIE P. DOUGLAS, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

No. 132

ESTATE OF CHARLES H. ROBINSON, NORTHWESTERN NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, JESSIE P. ROBINSON, ET AL., ETC., PETITIONERS,

vs.

COMMISSIONER OF INTERNAL REVENUE

No. 133

BERNICE B. DALRYMPLE, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

INDEX.

	Original	Print
Proceedings in U. S. C. C. A., Eighth Circuit	a	1
Caption (omitted in printing)	a	
Proceedings before United States Board of Tax Appeals	1	1
Order enlarging time to file transcript of record	1	1
Docket entries in Case No. 102870	2	2
Docket entries in Case No. 102869	5	5
Docket entries in Case No. 106705	8	7
Proceedings in Case No. 102870	10	9

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., JANUARY 25, 1944.

	Original	Print
Proceedings before United States Board of Tax Appeals—Continued		
Amended petition of Bessie P. Douglas	10	9
Exhibit "A"—Notice to Bessie P. Douglas of deficiency in tax, March 9, 1940	14	12
Statement	15	13
Answer of Commissioner of Internal Revenue to amended petition	17	16
Proceedings in Case No. 102869	18	17
Amended petition of Estate of Charles H. Robinson, et al., co-executors	18	17
Exhibit "A"—Notice to Estate of Charles H. Robinson, et al., co-executors, of deficiency in tax, March 9, 1940	24	21
Statement	25	22
Answer of Commissioner of Internal Revenue to amended petition	27	24
Proceedings in Case No. 106705	28	25
Petition of Bernice B. Dalrymple	28	25
Exhibit "A"—Notice to Bernice B. Dalrymple of deficiency in tax, December 30, 1940	33	29
Statement	34	31
Answer of Commissioner of Internal Revenue	36	33
Reply of Bernice B. Dalrymple to answer of Commissioner of Internal Revenue	38	35
Stipulation of facts	39	36
Excerpt from transcript of hearing relating to additional stipulation of fact	47	43
Opinion of United States Board of Tax Appeals, Turner, M.	47	45
Order of redetermination in Case No. 102870, May 9, 1942	57	53
Order of redetermination in Case No. 102869, May 9, 1942	58	54
Order of redetermination in Case No. 106705, May 9, 1942	58	54
Petition of Bessie P. Douglas in Case No. 102870 for review of decision of United States Board of Tax Appeals	59	55
Jurisdiction	59	55
Nature of controversy	60	56
Assignments of error	61	57
Notice of filing of petition for review by Bessie P. Douglas in Case No. 102870 and acknowledgment of service	63	58
Petition of Guy T. Helvering, Commissioner of Internal Revenue, in Case No. 102870 for review of decision of United States Board of Tax Appeals	64	59
Assignments of error	65	60
Notice of filing of petition for review by Guy T. Helvering, Commissioner of Internal Revenue, in Case No. 102870 and acknowledgment of service	66	61
Petition of Estate of Charles H. Robinson, et al., co-executors, in Case No. 102869 for review of decision of United States Board of Tax Appeals	67	61
Jurisdiction	68	62

	Original	Print
Proceedings before United States Board of Tax Appeals—Continued		
Nature of controversy	68	62
Assignments of error	70	64
Notice of filing of petition for review by Estate of Charles H. Robinson, et al., co-executors, in Case No. 102860 and acknowledgment of service	71	65
Petition of Bernice B. Dalrymple in Case No. 106705 for review of decision of United States Board of Tax Appeals	72	65
Jurisdiction	73	66
Nature of controversy	73	66
Assignments of error	75	68
Notice of filing of petition for review by Bernice B. Dalrymple in Case No. 106705 and acknowledgment of service	76	68
Order of United States Circuit Court of Appeals for transmission of single consolidated transcript of record and as to consolidation of cases for briefing, hearing, argument and decision, etc.	77	69
Praecipe for consolidated record	79	70
Clerk's certificate to transcript..(omitted in printing)..	81	
Designation of portions of record to be contained in printed record on petitions to review	82	72
Appearances of counsel.....(omitted in printing)..	84	
Order of submission	85	74
Opinion, U. S. Circuit Court of Appeals, Thomas, J.	87	75
Judgment, U. S. Circuit Court of Appeals, in Causes Nos. 12,461 and 12,462	96	83
Judgment, U. S. Circuit Court of Appeals, in Cause No. 12463	97	84
Judgment, U. S. Circuit Court of Appeals, in Cause No. 12464	98	84
Clerk's certificate to transcript.....(omitted in printing)...	99	
Orders allowing certiorari	101	85

[fol. a] [Caption omitted]

[fol. 1]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 102870

BESSIE P. DOUGLAS, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 102870

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

BESSIE P. DOUGLAS, Respondent

Docket No. 102869

Estate of CHARLES H. ROBINSON, Northwestern National Bank and Trust Company of Minneapolis, Jessie P. Robinson and Charles J. Robinson, Co-Executors, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 106705

BERNICE B. DALRYMPLE, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

ORDER ENLARGING TIME TO FILE TRANSCRIPT OF RECORD

Upon joint motion of counsel for the parties, it is

Ordered that the time for preparation, transmission and delivery of the record sur petitions for review of the above-entitled proceedings in the United States Circuit Court of Appeals for the Eighth Circuit is extended to October 31, 1942.

J. E. Murdock, Member.

Dated: Washington, D. C., August 24, 1942.

[fol. 2] Now Oct. 19, 1942, the foregoing order certified from the record as a true copy.

B. D. Gamble, Clerk, U. S. Board of Tax Appeals.
(Seal of U. S. Board of Tax Appeals.)

(Endorsed:) Nos. 12,461-2-3-4. Filed in U. S. Circuit Court of Appeals on October 28, 1942.

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 102870

BESSIE P. DOUGLAS, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DOCKET ENTRIES

Appearances:

For Taxpayer: James E. O'Brien, Esq., Kimball B. DeVoy, Esq.

For Comm'r.: E. M. Woolf, Esq., R. C. Whitley, Esq., S. U. Hiken, Esq.

1940

May 22. Petition received and filed. Taxpayer notified. Fee not paid.

May 22. Request for Circuit hearing in St. Paul, Minn. filed by taxpayer.

May 27. Fee paid—check.

May 28. Copy of Petition served on General Counsel.

Jul. 8. Motion to dismiss—rule 6(d)(e) and (h) filed by General Counsel.

Jul. 10. Hearing set July 31, 1940 on motion to dismiss.

Jul. 27. Amended petition filed by taxpayer. 7/29/40 copy served.

Jul. 31. Hearing had before Mr. Kern on motion of respondent to dismiss. Denied. Amended petition filed—usual time allowed to answer.

Jul. 31. Order that motion to dismiss be denied and respondent is allowed 60 days to answer or 45 days to move, entered.

[fol. 3] Aug. 29. Answer filed by General Counsel to amended petition.

Aug. 29. Request for hearing in Saint Paul, Minn. filed by General Counsel.

Sep. 5. Copy of answer and request served on taxpayer. St. Paul, Minn.

Sep. 18. Motion for decision by the Board filed by General Counsel.

Sep. 25. Hearing set Oct. 9, 1940 on motion.

Sep. 30. Motion for a continuance to Oct. 30, 1940 filed by taxpayer. 10/1/40 granted.

Oct. 29. Motion for leave to amend, embodying amendment filed by taxpayer. 10/29/40 copy served.

Oct. 30. Hearing had before Mr. Murdock on motion of respondent for decision—denied and on motion of petitioner to amend—withdrawn. Notice of appearance of J. E. O'Brien and Kimball B. DeVoy filed at hearing.

Oct. 30. Order denying respondent's motion filed Sept. 18, 1940 and leave is granted counsel for the petitioners to withdraw the motion filed Oct. 29, 1940 for leave to amend the petition, entered.

Nov. 12. Transcript of hearing of 10/30/40 filed.

Dec. 6. Motion for leave to amend, embodying amendment, filed by taxpayer. 12/12/40 granted.

Dec. 14. Copy of motion to amend amended petition served on General Counsel.

1941

Jan. 22. Answer to amendment to amended petition filed by General Counsel. 1/23/41 copy served.

Apr. 28. Hearing set June 16, 1941 at St. Paul, Minn.

May 6. Application for subpoena duces tecum to the Commissioner of Internal Revenue, filed by taxpayer. 5/8/41 subpoena issued.

[fol. 4] June 16. Hearing had before Mr. Turner on merits. Submitted. Counsel moves to consolidate dockets 102869, 70, 71 and 106705—granted. Appearance of Kimball B. DeVoy filed. Stipulation as to facts filed. Memorandum of Law filed. Petitioner's brief due 7/31/41. Respondent's reply brief due Aug. 15, 1941.

Jul. 23. Transcript of hearing of 6/16/41 filed.

Jul. 28. Brief filed by taxpayer. 9/12/41 copy served.

Sep. 27. Reply brief filed by General Counsel.

1942

Apr. 14. Opinion rendered, Turner, Div. 8. Decision will be entered under Rule 50. 4/14/42 copy served.

Apr. 29. Computation of deficiency filed by General Counsel.

May 1. Hearing set May 20, 1942 on settlement.

May 7. Consent to settlement filed by taxpayer.

May 9. Decision entered, Turner, Div. 8.

Aug. 3. Petition for review by U. S. Circuit Court of Appeals, 8th Circuit, with assignments of error filed by Taxpayer.

Aug. 3. Proof of service filed.

Aug. 7. Petition for review by U. S. Circuit Court of Appeals, 8th Circuit with assignments of error filed by General Counsel.

Aug. 12. Proof of service filed.

Aug. 18. Proof of service filed.

Aug. 24. Joint motion for extension of time to Nov. 1, 1942 to prepare and transmit record filed.

Aug. 24. Order enlarging time to Oct. 31, 1942 to prepare and transmit record entered.

Sep. 3. Certified copy of order from the 8th Circuit that the Clerk of the Board transmit to this Court a single consolidated transcript of record and that these proceedings [fol. 5] be consolidated for hearing, briefing, argument and decision; that one brief be filed on behalf of the petitioners and one on behalf of the Commissioner and that the first brief shall be filed by the taxpayer filed.

Sep. 29. Joint praecipe for consolidated record filed.

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 102869

ESTATE OF CHARLES H. ROBINSON, NORTHWESTERN NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, Jessie P. Robinson and Charles J. Robinson, Co-Executors, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DOCKET ENTRIES

Appearances:

For Taxpayer: James E. O'Brien, Esq., Kimball B. DeVoy, Esq.

For Comm'r.: E. M. Woolf, Esq., R. C. Whitley, Esq., S. U. Hiken, Esq.

1940

May 22. Petition received and filed. Taxpayer notified. Fee not paid.

May 22. Request for Circuit hearing in St. Paul, Minn. filed by taxpayer.

May 27. Fee paid—check.

May 28. Copy of petition served on General Counsel.

Jul. 8. Motion to dismiss—rule 6(d) (e) and (h) filed by General Counsel.

Jul. 10. Hearing set July 31, 1940 on motion to dismiss.

Jul. 27. Amended petition filed by taxpayer. 7/29/40 copy served.

Jul. 31. Hearing had before Mr. Kern on motion of respondent to dismiss. Denied. Amended petition filed—usual time allowed to answer.

[fol. 6] Jul. 31. Order that motion to dismiss be denied and respondent is allowed 60 days to answer or 45 days to move, entered.

Aug. 29. Answer filed by General Counsel to amended petition.

Aug. 29. Request for hearing in St. Paul, Minn. filed by General Counsel.

Sep. 5. Copy of answer and request served on taxpayer. St. Paul, Minn.

Sep. 18. Motion for decision by the Board filed by General Counsel.

Sep. 25. Hearing set Oct. 9, 1940 on motion.

Sep. 30. Motion for a continuance to Oct. 30, 1940 filed by taxpayer. 10/1/40 granted.

Oct. 29. Motion for leave to amend, embodying amendment filed by taxpayer. 10/29/40 copy served.

Oct. 30. Hearing had before Mr. Murdock on motion of respondent for decision—denied and on motion of petitioner to amend—withdrawn. Notice of appearance of J. E. O'Brien and Kimball B. DeVoy filed at hearing.

Oct. 30. Order denying respondent's motion filed Sept. 18, 1940 and leave is granted counsel for the petitioners to withdraw the motion filed Oct. 29, 1940 for leave to amend the petition, entered.

Nov. 12. Transcript of hearing of 10/30/40 filed.

Dec. 6. Motion for leave to amend, embodying amendment, filed by taxpayer. 12/12/40 granted.

Dec. 14. Copy of motion to amend amended petition served on General Counsel.

1941

Jan. 22. Answer to amendment to amended petition filed by General Counsel. 1/23/41 copy served.

Apr. 28. Hearing set June 16, 1941 at St. Paul, Minn. [fol. 7] May 6—Application for subpoena duces tecum to the Commissioner of Internal Revenue, filed by taxpayer.

May 8. Subpoena to Guy T. Helvering issued.

Jun. 16. Hearing had before Mr. Turner on merits. Submitted. Counsel moves to consolidate dockets 102869, 70, 71 and 106705—granted. Appearance of Kimball B. DeVoy filed. Stipulation as to facts filed. Memorandum of Law filed. Petitioner's briefs due 7/31/41. Respondent's reply brief due Aug. 15, 1941.

Jul. 23. Transcript of hearing of 6/16/41 filed.

Jul. 28. Brief filed by taxpayer. 9/12/41 copy served.

Sep. 27. Reply brief filed by General Counsel.

1942

Apr. 14. Opinion rendered, Turner, Div. 8. Decision will be entered under Rule 50. 4/14/42 copy served.

Apr. 29. Computation of deficiency filed by General Counsel.

May 1. Hearing set May 20, 1942 on settlement.

May 7. Consent to settlement filed by taxpayer.

May 9. Decision entered, Turner, Div. 8.

Aug. 3. Petition for review by U. S. Circuit Court of Appeals, 8th Circuit with assignments of error filed by taxpayer.

Aug. 3. Proof of service filed.

Aug. 24. Joint motion for extension of time to Nov. 1, 1942 to prepare and transmit the record filed.

Aug. 24. Order enlarging time by Oct. 31, 1942 to prepare and transmit record entered.

Sep. 3. Certified copy of order from the 8th Circuit that the Clerk of the Board transmit to this Court a single consolidated transcript of record and that these proceed-
[fol. 8] ings be consolidated for hearing, briefing, argument and decision; that one brief be filed on behalf of the taxpayers and one on behalf of the Commissioner and that the first brief shall be filed by the taxpayer filed.

Sep. 29. Joint praecipe for consolidated record filed.

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 106705

BERNICE B. DALRYMPLE, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DOCKET ENTRIES

Appearances:

For Taxpayer: James E. O'Brien, Esq., Kimball B. DeVoy, Esq.

For Comm'r: S. U. Hiken, Esq.

1941

Mar. 20. Petition received and filed. Taxpayer notified. Fee paid.

Mar. 20. Copy of petition served on General Counsel.

Mar. 20. Request for Circuit hearing in St. Paul, Minn. filed by taxpayer. 3/20/41 copy served.

Apr. 22. Answer filed by General Counsel.

Apr. 24. Copy of answer served on taxpayer. St. Paul, Minn.

May 2. Reply to answer filed by taxpayer. 5/2/41 copy served.

May 6. Application for subpoena duces tecum to Commissioner of Internal Revenue filed by taxpayer.

May 8. Subpoena duces tecum to Guy T. Helvering issued.

May 19. Joint motion to set for hearing 6/16/41 at St. Paul, Minn. filed. 5/21/41 granted.

May 22. Hearing set June 16, 1941 at St. Paul, Minn.

[fol. 9] Jun. 16. Hearing had before Mr. Turner on the merits. Appearance of Kimball B. DeVoy filed. Stipulation as to facts filed. Memorandum of Law filed. Petitioner's brief due 7/31/41. Respondent's reply brief due Aug. 15, 1941.

Jul. 23. Transcript of hearing of 6/16/41 filed.

Jul. 28. Brief filed by taxpayer. 9/12/41 copy served.

Sep. 27. Reply brief filed by General Counsel.

1942

Apr. 14. Opinion rendered, Turner, Div. 8. Decision will be entered under Rule 50. 4/14/42 copy served.

Apr. 29. Computation of deficiency filed by General Counsel.

May 1. Hearing set May 20, 1942 on settlement.

May 7. Consent to settlement filed by taxpayer.

May 9. Decision entered, Turner, Div. 8.

Aug. 3. Petition for review by U. S. Circuit Court of Appeals, 8th Circuit, with assignments of error filed by taxpayer.

Aug. 3. Proof of service filed.

Aug. 24. Joint motion for extension of time to 11/1/42 to prepare and transmit record filed.

Aug. 24. Order enlarging time to Oct. 31, 1942 to prepare and transmit record entered.

Sep. 3. Certified copy of order from the 8th Circuit that the Clerk of the Board transmit to this Court a single consolidated transcript of record and that these proceedings be consolidated for hearing, briefing, argument and decision; that one brief be filed on behalf of the petitioner's and one on behalf of the Commissioner and that the first brief shall be filed by the taxpayer filed.

Sep. 29. Joint praecipe for consolidated record filed.

[fol. 10] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

AMENDED PETITION OF BESSIE P. DOUGLAS IN CASE NO. 102870
—Filed July 27, 1940

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbol: LGE 90D) dated March 9, 1940, and as a basis of her proceeding alleges as follows:

1. That petitioner is an individual, and resides at 2424 Park Avenue, Minneapolis, Minnesota. The return for the period here involved was filed with the Collector for the collection district of Minnesota.

2. The notice of deficiency (a copy of which is attached hereto, marked Exhibit "A", and made a part hereof) was mailed to the petitioner on March 9, 1940.

3. The taxes in controversy are income taxes for the calendar year 1937 and in the amount of $30,024.60 alleged deficiency.

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(1) The Commissioner erred in determining that there should be disallowed as a deduction the sum of $7,437.08 deducted from gross income on taxpayer's return for the taxable year 1937 as depletion suffered on the mining property owned by taxpayer known as the Pettit Mine, such action of the Commissioner being in violation of Section 23 (m), Revenue Act of 1936.

(2) The Commissioner erred in determining that there should be included in taxpayer's gross income for the taxable year 1937 amounts received by taxpayer at various times in the years 1929 to 1936 inclusive, totaling $53,299.03, and being equal to the aggregate of deductions for depletion on the said Pettit Mine taken by taxpayer on her returns for the taxable years 1929 to 1936 inclusive, such action of [fol. 11] the Commissioner being in violation of Section 23 (m) and Section 42 of the Revenue Act of 1936.

(3) The Commissioner erred in determining that taxpayer realized in the taxable year 1937 income in the

amount of $53,299.03 by reason of the termination in 1937, of a mining lease on said Pettit Mine without extraction of ore on which advance royalties had been paid and in respect of which depletion had been taken by taxpayer in years prior to 1937, such action of the Commissioner being in violation of Section 22 (a) of the Revenue Act of 1936.

(4) The Commissioner erred in determining that there is a deficiency in petitioner's income tax liability for the taxable year 1937 in excess of $1,158.37.

(5) The Commissioner erred by making the above specified determinations under the provisions of Article 23 (m)-10 of Regulations 94, and corresponding provisions of prior regulations, in violation of Section 22 (a), Section 23 (m), Section 41 and Section 42 of the Revenue Act of 1936.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(1) Taxpayer owns an undivided one-half fee interest in a particular iron ore mine situated in St. Louis County, Minnesota, known as the "Pettit" mine, and has owned said undivided fee interest since the time the income tax law became effective in March, 1913.

• • • • • • •

(5) In 1929 taxpayer, together with the other fee owners, leased the said Pettit mine to the Republic Steel Company of Youngstown, Ohio, for a period of 30 years, said lease commencing to run July 1, 1929. Taxpayer here, by virtue of her undivided one-half interest in the property, was entitled to one-half of the royalties paid on the said lease.

A. Under the terms of this lease the Republic Steel Company was to pay a royalty of forty (40) cents per ton of ore removed from the said Pettit mine.

B. The lease provided for the payment of minimum royalties of $20,000.00 per year each year during the first [fol. 12] four years of the life of the lease and $40,000.00 per year minimum royalties for the remaining years of the lease, with a proviso that if the said lessee failed to pump out and remove certain water then in the mine, within five years after the lease was entered into, then the minimum royalties were to be $60,000.00 each year during the period that the lessee failed to remove the water from the mine.

C. The lease provided that the lessee was to be entitled to credit for the amount of any and all such minimum royalties paid by it in advance of the removal of ore and was to have a right to have the advance payments applied toward the payment of royalties accruing to the lessor on account of ore mined in excess of the minimum royalty payment, in some subsequent year.

D. The lessee was to have a right to terminate the lease at any time, upon proper notice, except that it was agreed that, at all events, the lease was to remain in full force and effect for seven years from the date of execution.

E. In May, 1933 the lease was amended so as to provide for the payment of $20,000.00 advance royalties per year, for the first five years of the life of the lease instead of the first four years of such life and the lease was further amended so that it could not be terminated by the lessee for eight years instead of seven, as originally provided.

(6) The Republic Steel Company, lessee, entered into possession of the mine in 1929, and, in accordance with the terms of the lease, paid the required minimum royalties until July, 1937. The royalties received by taxpayer here and the depletion taken against the royalties are as follows:

Year	Royalties Received	Depletion Taken
1929	$2,500.00	$1,239.51
1930	10,000.00	4,958.05
1931	10,000.00	4,958.05
1932	10,000.00	4,958.05
1933	10,000.00	4,958.05
1934	12,500.00	6,197.56
1935	22,500.00	11,155.61
1936	30,000.00	14,874.15
1937	15,000.00	7,437.08

[fol. 13] The depletion was taken on the so-called "cost" basis. Total royalties received by petitioner amounted to $122,500.00. Total depletion taken amounted to $60,736.11.

(7) In 1937 the Republic Steel Company voluntarily terminated the lease according to the terms thereof, thereby

releasing all interest which it had in the mining property including the right to remove ore paid for by the minimum royalties.

(8) No ore had been removed from the mine by the said lessee, Republic Steel Company, prior to the time of cancellation.

* * * * * * *

Wherefore, petitioner prays that this Board may hear the proceeding and declare that the Commissioner erred in each of the particulars specified in petitioner's assignments of error herein, and that there is no tax deficiency in excess of $1,158.37 due from petitioner to the United States Government.

James E. O'Brien, Counsel. 808 First National-Soo Line Bldg. Minneapolis, Minnesota.

Dated July 19th, 1940.

Duly sworn to by Bessie P. Douglas. Jurat omitted in printing.

[fol. 14] EXHIBIT "A" TO AMENDED PETITION

Treasury Department
Internal Revenue Service
St. Paul, Minnesota

Office of Internal Revenue Agent in Charge St. Paul Division, 800 Post Office Building

Mar. 9, 1940.

Bessie P. Douglas, 2424 Park Avenue, Minneapolis, Minnesota

Collection District: Minnesota

Madam:

You are advised that the determination of your income tax liability for the taxable year 1937 discloses a deficiency of $30,024.60 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the internal revenue agent in charge, St. Paul, Minnesota for the attention of LGE-90D. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully, Guy T. Helvering, Commissioner, By C. W. Rink, Internal Revenue Agent in Charge.

Enclosures: Statement Form of waiver.

[fol. 15]

STATEMENT

Bessie P. Douglas,

2424 Park Avenue,

Minneapolis, Minnesota

Tax Liability for Taxable Year Ended December 31, 1937

Income tax	Liability	Assessed	Deficiency
	$36,499.33	$6,474.73	$30,024.60

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated May 15, 1939; to your protest dated July 5, 1939, and to Statements made at conferences held on September 27, 1939 and November 28, 1939.

A copy of this letter and statement has been mailed to Mr. James E. O'Brien, 808 First National-Soo Line Building, Minneapolis, Minnesota, in accordance with the authority contained in the power of attorney executed by you.

Adjustments to Net Income

Net income as disclosed by return		$41,666.89
Unallowable deductions and additional income:		
(a) Adjustment of depletion Corsica Mine	$4,031.14	
(b) Depletion disallowed on Pettit Mine	7,437.08	
(c) Amount included in income equal to depletion deductions allowed in years prior to 1937	53,299.03	
(d) Cost of preparation of return	125.00	64,892.25
Net income adjusted		106,559.14

Explanation of Adjustments

(a) To adjust depletion on Corsica Mine to the amount allowable as shown below:

199642 ton- at $.166216 per ton	$33,183.69
Less: 20% of depletion allowable to husband, George P. Douglas	6,636.74
Depletion allowable	26,546.95
Depletion claimed	30,578.09
Adjustment of depletion on Corsica Mine	4,031.14

(b) Under conditions known to exist during the year 1937, it is held that no depletion is allowable for that year [fol. 16] as the result of the receipt by you of advance or minimum royalties under the provisions of the lease agreement with the Republic Steel Company relating to the Pettit Mine.

(c) For the taxable years 1929 to 1936, inclusive, you claimed and were allowed depletion aggregating $53,299.03 in respect of minimum or advance royalties under the lease agreement with the Republic Steel Company relating to the Pettit Mines, pursuant to the provisions of the Regulations then in force corresponding to Article 23(m)-10 of Regulations 94. Such regulations provided that if for any reason the mineral lease expires or terminates or is abandoned before the mineral which has been paid for in advance has

been extracted and removed, the lessor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned. The lessee failed to remove any ore from the mine, and during the year 1937 elected to terminate the above-mentioned lease agreement and abandoned the right to extract and remove the mineral which had been paid for by minimum or advance royalties paid in prior years. It is held that in accordance with the provisions of Article 23(m)-10 of Regulations 94, and corresponding provisions of prior regulations, you derived income in the year 1937 equal to the amounts so deducted and allowed as depletion in prior years.

(d) This represents the disallowance of amount paid in connection with the preparation of your income tax return. This does not represent an ordinary and necessary business expense incurred in connection with your business as required by section 23(a) of the Revenue Act of 1936.

Computation of Tax

Net income adjusted	$106,559.14
Less: Personal exemption	2,500.00
Balance (surtax net income)	104,059.14
Less: Earned income credit (10% of $3,000.00)	300.00
Net income subject to normal tax	103,759.14
[fol. 17] Normal tax at 4% on $103,759.14	4,150.37
Surtax on $104,059.14	32,354.31
Total tax	36,504.68
Less: Income tax paid at the source	5.35
Corrected income tax liability	36,499.33
Income tax assessed:	
Original, Account No. 200371	6,474.73
Deficiency of income tax	30,024.60

BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

ANSWER OF COMMISSIONER OF INTERNAL REVENUE TO AMENDED PETITION OF BESSIE P. DOUGLAS IN CASE NO. 102870—Received and Filed August 29, 1940

Now comes the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the amended petition filed herein admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the amended petition.

2. Admits the allegations contained in paragraph 2 of the amended petition.

3. Admits that the taxes in controversy are income taxes for the calendar year 1937, as alleged in paragraph 3 of the amended petition, and denies the remainder of said paragraph.

4. Denies that the respondent erred as alleged in paragraph 4 of the amended petition.

5. (1). Admits the allegations contained in subparagraph (1) of paragraph 5 of the amended petition.

[fol. 18] 5. (2), (3) and (4). Denies the allegations contained in subparagraphs (2), (3) and (4) of paragraph 5 of the amended petition.

5. (5), (6), (7) and (8). Admits the allegations contained in subparagraphs (5), (6), (7) and (8) of paragraph 5 of the amended petition.

5. (9), (10), (11) and (12). Denies the allegations contained in subparagraphs (9), (10), (11) and (12) of paragraph 5 of the amended petition.

Denies generally and specifically each and every allegation contained in the amended petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, respondent prays that the Board redetermine the deficiency herein to be the amount determined by the

Commissioner, viz.: $30,024.60 in respect of income taxes for the taxable year 1937.

J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

Of Counsel: F. R. Shearer, Division Counsel; Henderson A. Melville, Special Attorney, Bureau of Internal Revenue.

BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

AMENDED PETITION OF ESTATE OF CHARLES H. ROBINSON, ET AL., CO-EXECUTORS, IN CASE NO. 102,869—Filed July 27, 1940

The above named petitioners hereby petition for a redetermination of the deficiency set forth by the Commis- [fol. 19] sioner of Internal Revenue in his notice of deficiency (Bureau Symbol: LGE 90D) dated March 9, 1940, and as a basis of their proceeding allege as follows:

1. That petitioners are the co-executors of the Estate of Charles H. Robinson. The Northwestern National Bank and Trust Company of Minneapolis is a national banking association with offices at Minneapolis, Minnesota. Jessie P. Robinson and Charles J. Robinson are individuals, co-executors of the said estate, and both residents of the City of Minneapolis, State of Minnesota. The return for the period here involved was filed with the Collector of Internal Revenue for the collection district of Minnesota.

2. The notice of deficiency (a copy of which is attached hereto, marked Exhibit "A", and made a part hereof) was mailed to the petitioners on March 9, 1940.

3. The taxes in controversy are income taxes for the calendar year 1937 and in the amount of $1,532.38, alleged deficiency, plus the sum of $230.87 overpayment alleged by petitioners.

4. The determination of tax set forth in the notice of deficiency is based upon the following errors:

(1) The Commissioner erred in determining that there should be disallowed as a deduction the sum of $1,724.00

deducted from gross income on taxpayer's return for the taxable year 1937 as depletion suffered on the mining property owned by taxpayers known as the Pettit Mine, such action of the Commissioner being in violation of Section 23(m), Revenue Act of 1936.

(2) The Commissioner erred in determining that there should be included in taxpayers' gross income for the taxable year 1937 amounts received by taxpayers at various times in the years 1932 to 1936 inclusive, totaling $9,829.14, and being equal to the aggregate of deductions for depletion on the said Pettit Mine taken by the estate on its returns for the taxable years 1932 to 1936 inclusive, such action of the Commissioner being in violation of Section 23(m) and Section 42 of the Revenue Act of 1936.

(3) The Commissioner erred in determining that taxpayers realized in the taxable year 1937 income in the [fol. 20] amount of $9,829.14 by reason of the termination in 1937 of a mining lease on said Pettit Mine without extraction of ore on which advance royalties had been paid and in respect of which depletion had been taken by taxpayer in years prior to 1937, such action of the Commissioner being in violation of Section 22(a) of the Revenue Act of 1936.

(4) The Commissioner erred in determining that there is a deficiency in petitioner's income tax liability for the taxable year 1937.

(5) The Commissioner erred in failing to determine that there was an overpayment by the taxpayers in the amount of $230.87.

(6) The Commissioner erred by making the above specified determinations under the provisions of Article 23(m)-10 of Regulations 94, and corresponding provisions of prior regulations, in violation of Section 22(a), Section 23(m), Section 41 and Section 42 of the Revenue Act of 1936.

5. The facts upon which petitioners rely as the basis of this proceeding are as follows:

(1) Charles H. Robinson died August 16, 1932, a resident of and domiciled in Minneapolis, Minnesota. At the time of his death Charles H. Robinson owned an undivided

one-sixth fee interest in a particular iron ore mine situated in St. Louis County, State of Minnesota, known as the "Pettit" mine.

(2) Since the time of death of the said Charles H. Robinson the property has been administered by the above named executors of the Estate of Charles H. Robinson, petitioners herein.

. . . . . .

(5) At the time of death of the said Charles H. Robinson the said Pettit mine had been leased by the said Charles H. Robinson and the other fee owners to the Republic Steel Company of Youngstown, Ohio, for a period of thirty years, beginning July 1, 1929.

A. Under the terms of this lease the Republic Steel Company was to pay a royalty of forty (40) cents per ton for each ton of ore removed from the said Pettit mine.

[fol. 21] B. The lease provided for the payment of minimum royalties of $20,000.00 per year each year during the first four years of the life of the lease and $40,000.00 per year minimum royalties for the remaining years of the lease, with a proviso that if the said lessee failed to pump out and remove certain water then in the mine, within five years after the lease was entered into, then the minimum royalties were to be $60,000.00 each year during the period that the lessee failed to remove the water from the mine.

C. The lease provided that the lessee was to be entitled to credit for the amount of any and all such minimum royalties paid by it in advance of the removal of ore and was to have a right to have the advance payments applied toward the payment of royalties accruing to the lessor on account of ore mined in excess of the minimum royalty payment, in some subsequent year.

D. The lessee was to have a right to terminate the lease at any time, upon proper notice, except that it was agreed that, at all events, the lease was to remain in full force and effect for seven years from the date of execution.

E. In May, 1933 the lease was amended so as to provide for the payment of $20,000.00 advance royalties per year, for the first five years of the life of the lease instead of the first four years of such life and the lease was further

amended so that it could not be terminated by the lessee for eight years instead of seven, as originally provided.

(6) The Republic Steel Company, lessee, entered into possession of the mine in 1929, and, in accordance with the terms of the lease paid the required minimum royalties until July, 1937. The Estate received the following income and took the following depletion allowances:

Year	Royalty Received	Depletion Claimed
8-16-32 to 12-31-32	$833.33	$413.19
1933	3,333.32	1,176.00
1934	4,166.66	2,065.94
1935	7,500.00	2,646.01
1936	10,000.00	3,528.00
1937	5,000.00	1,724.00

[fol. 22] The total royalties received were $30,833.31. The total depletion taken was $11,553.14. Depletion was taken on the so-called "cost basis."

(7) In 1937 the Republic Steel Company voluntarily terminated the lease according to the terms thereof, effective July 1, 1937, thereby releasing all interest which it had in the mining property including the right to remove ore paid for my the minimum royalties.

(8) No ore had been removed from the mine by the said lessee, Republic Steel Company, prior to the time of cancellation.

* * * * * * *

Wherefore, petitioners pray that this Board may hear the proceeding and declare that the Commissioner erred in each of the particulars specified in petitioners' assignments of error herein, and that there is no tax deficiency due from the petitioners to the United States Government; and petitioners further pray that this Board determine an overpayment of taxpayers' 1937 income tax in the amount of $230.87.

James E. O'Brien, Counsel, 808 First National-Soo Line Bldg., Minneapolis, Minnesota.

Dated July 20th, 1940.

STATE OF MINNESOTA,
County of Hennepin—ss.:

Jessie P. Robinson and Charles J. Robinson, being duly sworn, say that they are two of the co-executors of the Estate of Charles H. Robinson, above named, and that they have authority to act herein for the said estate and for the co-executors thereof; that they have read the foregoing petition and are familiar with the statements contained therein and that the statements contained therein are true except those stated to be on information and belief, and that those they believe to be true.

Jessie P. Robinson, Charles J. Robinson.

[fol. 23] Subscribed and sworn to before me this 20th day of July, 1940. S. T. Persen, Notary Public, Henn. Co., Minn. My Commission expires April 24, 1942. (Seal.)

Duly sworn to by C. E. Drake and S. H. Rogers. Jurat omitted in printing.

[fol. 24] EXHIBIT "A" TO AMENDED PETITION

Treasury Department
Internal Revenue Service
St. Paul, Minnesota

Office of Internal Revenue Agent in Charge St. Paul Division, 800 Post Office Bldg.

March 9, 1940.

Estate of Charles H. Robinson, Northwestern National Bank and Trust Company, Co-executor, Minneapolis, Minnesota.

Collection District: Minnesota

SIRS:

You are advised that the determination of your income tax liability for the taxable year 1937 discloses a deficiency of $1,532.38 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the internal revenue agent in charge, St. Paul, Minnesota for the attention of LGE-90D. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully, Guy T. Helvering, Commissioner, By C. W. Rink, Internal Revenue Agent in Charge.

Enclosures: Statement Form of waiver. LGE/mer.

[fol. 25] STATEMENT

Estate of Charles H. Robinson, Northwestern National Bank and Trust Company, Co-executor, Minneapolis, Minnesota

Tax Liability for Taxable Year Ended December 31, 1937

	Liability	Assessed	Deficiency
Income tax	$2,592.04	$1,059.66	$1,532.38

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated May 19, 1939; to your protest dated July 6, 1939; and to statements made at conferences held on September 27, 1939 and November 28, 1939.

A copy of this letter and statement has been mailed to James E. O'Brien, 808 First National-Soo Line Building, Minneapolis, Minnesota, in accordance with the authority contained in the power of attorney executed by you.

Adjustments to Net Income

Net income as disclosed by return		$14,163.86
Unallowable deductions and additional income:		
(a) To disallow depletion on Pettit Mine	$1,724.00	
(b) Amount included in income equal to depletion deductions allowed in years prior to 1937	9,829.14	11,553.14
		25,717.00
Nontaxable income and additional deductions:		
(c) To adjust depletion on Corsica Mine		1,993.01
Net income adjusted		23,723.99

Explanation of Adjustments

(a) Under conditions known to exist during the year 1937, it is held that no depletion is allowable for that year as the result of the receipt by you of advance or minimum royalties under the provisions of the lease agreement with the Republic Steel Company relating to the Pettit Mine.

(b) For the taxable years 1932 to 1936, inclusive, you claimed and were allowed depletion aggregating $9,829.14 in respect of minimum or advance royalties under the lease agreement with the Republic Steel Company relating to the [fol. 26] Pettit Mine, pursuant to the provisions of the Regulations then in force corresponding to Article 23(m)-10 of Regulations 94. Such regulations provided that if for any reason the mineral lease expires or terminates or is abandoned before the mineral which has been paid for in advance has been extracted and removed, the lessor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned. The lessee failed to remove any ore from the mine, and during the year 1937 elected to terminate the above-mentioned lease agreement and abandoned the right to extract and remove the mineral which had been paid for by minimum or advance

royalties paid in prior years. It is held that in accordance with the provisions of Article 23(m)-10 of Regulations 94, and corresponding provisions of prior regulations, you derived income in the year 1937 equal to the amounts so deducted and allowed as depletion in prior years.

(c) To adjust depletion on Corsica Mine to the amount allowable as shown below:

199,642 tons at $.06177	$12,331.87
Depletion claimed	10,338.86
Additional depletion allowable	1,993.01

Computation of Tax

Net income adjusted	$23,723.99
Less: Personal exemption	1,000.00
Balance (surtax net income)	22,723.99
Net income subject to normal tax	22,723.99
Normal tax at 4% on $22,723.99	908.96
Surtax on $22,723.99	1,683.08
Total tax	2,592.04
Income tax assessed:	
Original, Account No. 185887	1,059.66
Deficiency of income tax	1,532.38

[fol. 27] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

ANSWER OF COMMISSIONER OF INTERNAL REVENUE TO AMENDED PETITION OF ESTATE OF CHARLES H. ROBINSON, ET AL., CO-EXECUTORS, IN CASE NO. 102,869—Received and Filed August 29, 1940

Now comes the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the amended petition filed herein admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the amended petition.

2. Admits the allegations contained in paragraph 2 of the amended petition.

3. Admits that the taxes in controversy are income taxes for the calendar year 1937, as alleged in paragraph 3 of the amended petition, and denies the remainder of said paragraph.

4. Denies that the respondent erred as alleged in paragraph 4 of the amended petition.

5. (1) and (2). Admits the allegations contained in subparagraphs (1) and (2) of paragraph 5 of the amended petition.

5. (3) and (4). Denies the allegations contained in subparagraphs (3) and (4) of paragraph 5 of the amended petition.

5. (5), (6), (7) and (8). Admits the allegations contained in subparagraphs (5), (6), (7) and (8) of paragraph 5 of the amended petition.

5. (9), (10), (11) and (12). Denies the allegations contained in subparagraphs (9), (10), (11) and (12) of paragraph 5 of the amended petition.

[fol. 28] Denies generally and specifically each and every allegation contained in the amended petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, respondent prays that the Board redetermine the deficiency herein to be the amount determined by the Commissioner, viz.: $1,532.38 in respect of income taxes for the taxable year 1937.

J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

Of Counsel: F. R. Shearer, Division Counsel; Henderson A. Melville, Special Attorney, Bureau of Internal Revenue.

BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PETITION OF BERNICE B. DALRYMPLE IN CASE NO. 106,705—Filed March 20, 1941

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commis-

sioner of Internal Revenue in his Notice of Deficiency dated December 30, 1940, and as a basis of the proceeding alleges as follows:

1. That petitioner is an individual, resident and domiciled in the City of Minneapolis, Minnesota, with her office at 953 Northwestern Bank Building. That petitioner is the transferee of all of the assets of the Estate of Irene B. Robinson Cirkler, Deceased. The return for the period herein involved was filed with the Collector for the Collection District of Minnesota. The return involved is the [fol. 29] return for Irene B. Robinson Cirkler, Deceased, an individual, resident and domiciled in Hollywood, State of California, covering the period from January 1, 1937, to October 20, 1937, the date of her death.

2. The Notice of Deficiency (a copy of which is attached hereto, marked Exhibit A, and made a part hereof) was mailed to the petitioner on December 30, 1940.

3. The taxes in controversy are income taxes for that part of the calendar year 1937 prior to the death of Irene B. Robinson Cirkler, deceased taxpayer, and in the amount of $5,412.47, alleged deficiency.

4. The determination of tax set forth in said Notice of Deficiency is based on the following errors:

(1) The Commissioner erred in determining that there should be disallowed as a deduction the sum of $5,371.44 deducted from gross income on decedent's return for the year 1937 as depletion suffered on the mining property owned by decedent known as the Pettit Mine, such action of the Commissioner being in violation of Section 23(m), Revenue Act of 1936.

(2) The Commissioner erred in determining that there should be included in the decedent's gross income for the taxable year 1937 amounts received by decedent at various times in the years 1929 to 1936, inclusive, totaling $18,180.26, and being equal to the aggregate deductions for depletion on the said Pettit Mine taken by decedent on her returns for the taxable years 1929 to 1936, inclusive, such action of the Commissioner being in violation of Section 23(m) and Section 42 of the Revenue Act of 1936.

(3) The Commissioner erred in determining that decedent realized in the year 1937 income in the amount of

$18,180.26 by reason of the termination in 1937 of a mining lease on said Pettit Mine without extraction of ore on which advance royalties had been paid and in respect of which depletion had been taken by decedent in years prior to 1937, such action of the Commissioner being in violation of Section 22(a) of the Revenue Act of 1936.

(4) The Commissioner erred in determining that there is a deficiency in decedent's income tax liability for the year 1937.

[fol. 30] (5) The Commissioner erred by making the above specified determinations under the provisions of Article 23(m)-10 of Regulations 94, and corresponding provisions of prior regulations, in violation of Section 22(a), Section 23(m), Section 41 and Section 42 of the Revenue Act of 1936.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(1) Irene B. Robinson Cirkler died on October 20, 1937. At the time of her death she was a resident of and domiciled in the City of Hollywood, State of California. During her lifetime the said Irene B. Robinson Cirkler owned an undivided one-sixth fee interest in a particular iron ore mine situated in St. Louis County, Minnesota, known as the "Pettit" Mine. The said decedent had acquired her interest in the property prior to March 1, 1913, and had continued to hold the property until the time of her death.

. . . . . .

(5) In 1929 decedent herein, together with the other fee owners, leased the said Pettit Mine to the Republic Steel Company of Youngstown, Ohio, for a period of thirty (30) years, said lease commencing to run July 1, 1929. Decedent was entitled to a one-sixth share in the royalties received from the said lease.

A. Under the terms of this lease the Republic Steel Company was to pay a royalty of forty (40) cents per ton for each ton of ore removed from the said Pettit Mine.

B. The lease provided for the payment of minimum royalties of $20,000.00 per year each year during the first four years of the life of the lease and $40,000.00 per year minimum royalties for the remaining years of the lease,

with a proviso that if the said lessee failed to pump out and remove certain water then in the mine, within five years after the lease was entered into, then the minimum royalties were to be $60,000.00 each year during the period that the lessee failed to remove the water from the mine.

C. The lease provided that the lessee was to be entitled to credit for the amount of any and all such minimum royalties paid by it in advance of the removal of ore and was to have a right to have the advance payments applied to-[fol. 31] ward the payment of royalties accruing to the lessor on account of ore mined in excess of the minimum royalty payment, in some subsequent year.

D. The lessee was to have a right to terminate the lease at any time, upon proper notice, except that it was agreed that, at all events, the lease was to remain in full force and effect for seven years from the date of execution.

E. In May, 1933, the lease was amended so as to provide for the payment of $20,000.00 advance royalties per year for the first five years of the life of the lease instead of the first four years of such life, and the lease was further amended so that it could not be terminated by the lessee for eight years instead of seven as originally provided.

(6) The Republic Steel Company, lessee, entered into possession of the mine in July, 1929, and paid royalties in accordance with the terms of the lease above described. Decedent's share of the royalties paid and the depletion which she took against said royalties were as follows:

Year	Royalty Received	Depletion Claimed
1929	$833.33	$413.19
1930	3,333.33	1,652.75
1931	3,333.33	1,652.75
1932	3,333.33	1,652.75
1933	3,333.33	1,652.75
1934	5,000.00	2,479.13
1935	7,500.00	3,718.69
1936	10,000.00	4,958.25
1937	10,833.33	5,371.44

Total royalties received by said decedent for the nine years were $47,499.98. Total depletion taken for the nine years

amounted to $23,551.70. Depletion was taken on the "cost" basis.

(7) In 1937 the Republic Steel Company voluntarily terminated the lease according to the terms thereof, effective July 1, 1937, thereby releasing all interest which it had in the mining property including the right to remove ore paid for by the minimum royalties.

[fol. 32] (8) No ore had been removed from the mine by the said lessee, Republic Steel Company, prior to the time of cancellation.

. . . . . .

(14) That petitioner is the transferee of all of the assets of the Estate of Irene B. Robinson Cirkler, Deceased.

Wherefore, Petitioner prays that this Board may hear the proceeding and declare that the Commissioner erred in each of the particulars specified in petitioner's assignments of error herein, and that there is no tax deficiency due from petitioner to the United States Government.

James E. O'Brien, Kimball B. DeVoy, Attorneys for Petitioner, 808 First National-Soo Line Building, Minneapolis, Minnesota.

Dated March 15th, 1941.

Duly sworn to by Bernice B. Dalrymple. Jurat omitted in printing.

[fol. 33] EXHIBIT "A" TO PETITION

Treasury Department
Internal Revenue Service
St. Paul, Minnesota

Dec. 30, 1940.

Office of Internal Revenue Agent in Charge St. Paul Division 800 Post Office Building

Bernice B. Dalrymple,
953 Northwestern Bank Building,
Minneapolis, Minnesota.

Collection District:
Minnesota.

MADAM:

You are advised that the determination of the income tax liability of the estate of Irene B. Robinson Cirkler, Deceased, Minneapolis, Minnesota, for the taxable year ended December 31, 1937, discloses a deficiency of $5,412.47, as shown in the statement attached.

The amount of the deficiency stated, plus interest as provided by law, constituting your liability as transferee of the assets of said estate of Irene B. Robinson Cirkler, Deceased, will be assessed against you.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the internal revenue agent in charge, St. Paul Minnesota, for the attention of LGE-90D. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period termi- [fol. 34] nates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully, Guy T. Helvering, Commissioner. By, C. W. Rink, Internal Revenue Agent in Charge.

Enclosures:
Statement.
Form of waiver.
LGE/mrr.

Bernice B. Dalrymple, Transferee

STATEMENT

Estate of Irene B. Robinson Cirkler, Deceased, Transferor,

953 Northwestern Bank Building,

Minneapolis, Minnesota.

Tax Liability for the Taxable Year Ended

December 31, 1937

Bernice B. Dalrymple,

953 Northwestern Bank Building,

Minneapolis, Minnesota

	Liability	Assessed	Deficiency
Income tax	$7,095.08	$1,682.61	$5,412.47

The records of this office indicate that assets of the above-named decedent's estate have been transferred to you.

The above-stated amount represents your liability as a transferee of assets of the estate of Irene B. Robinson Cirkler, deceased, 953 Northwestern Bank Building, for a deficiency in income tax due from the estate of Irene B. Robinson Cirkler, deceased, for the taxable year ended December 31, 1937.

Adjustments to Net Income

Net income as disclosed by return		$18,830.71
Unallowable deductions and additional income:		
(a) Depletion disallowed on Pettit Mine	$5,371.44	
(b) Amount included in income equal to depletion deductions allowed in years prior to 1937	18,180.26	23,551.70
Net income adjusted		42,382.41

[fol. 35] Explanation of Adjustments

(a) Under conditions known to exist during the year 1937, it is held that no depletion is allowable for that year as the result of the receipt by Irene B. Robinson Cirkler, deceased, of advance or minimum royalties under the provisions of the lease agreement with the Republic Steel Company relating to the Pettit Mine.

(b) For the taxable years 1929 to 1936, inclusive, Irene B. Robinson Cirkler, deceased, was allowed depletion aggregating $18,190.26 in respect of minimum or advance royalties under the lease agreement with the Republic Steel Company relating to the Pettit Mine, pursuant to the provisions of the Regulations then in force corresponding to Article 23(m)-10 of Regulations 94. Such regulations provided that if for any reason the mineral lease expires or terminates or is abandoned before the mineral which has been paid for in advance has been extracted and removed, the lessor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned. The lessee failed to remove any ore from the mine, and during the year 1937 elected to terminate the above-mentioned lease agreement and abandoned the right to extract and remove the mineral which had been paid for by minimum or advance royalties paid in prior years. It is held that in accordance with the provisions of Article 23(m)10 of Regulations 94, and corresponding provisions of prior regulations, Irene B. Robinson Cirkler, deceased, derived income in the year 1937 equal to the amounts so deducted and allowed as depletion in prior years.

Computation of Tax

Net income adjusted	$42,382.41
Less: Personal exemption	1,000.00
Balance (surtax net income)	41,382.41
Less: Earned income credit (10% of $3,000.00)	300.00
Net income subject to normal tax	41,082.41

Normal tax at 4% on $41,082.41	1,643.30
Surtax on $41,382.41	5,451.78
Total tax	7,095.08
Income tax assessed:	
Original, Account No. 807,171	1,682.61
Deficiency of income tax	5,412.47

[fol. 36] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

ANSWER OF COMMISSIONER OF INTERNAL REVENUE IN CASE No. 106705—Received and Filed April 22, 1941

Now comes the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein admits, denies and alleges as follows:

1. Admits the allegations contained in paragraph 1 of the petition, except it is denied that Irene B. Robinson Cirkler, Deceased, was a resident of and domiciled in Hollywood, California.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits that the taxes in controversy are income taxes for that part of the calendar year 1937 prior to the death of Irene B. Robinson Cirkler; denies the remaining allegations contained in paragraph 3 of the petition.

4. (1) to (5), inclusive. Denies that the respondent erred as alleged in subparagraphs (1) to (5), inclusive, of paragraph 4 of the petition.

5. (1). Admits that Irene B. Robinson Cirkler died on October 20, 1937; admits that during her lifetime she owned an undivided fee interest in an iron ore mine situated in St. Louis County, Minnesota, known as the "Pettit" Mine; denies the remaining allegations contained in subparagraph (1) of paragraph 5 of the petition.

5. (2), (3) and (4). Denies the allegations contained in subparagraphs (2), (3) and (4) of paragraph 5 of the petition.

5. (5). Admits that in 1929 the decedent, together with the other fee owners, leased the said "Pettit" Mine to the Republic Steel Company of Youngstown, Ohio; admits that [fol. 37] the decedent was entitled to a share in the royalties received from said lease; denies the remaining allegations contained in subparagraph (5) of paragraph 5 of the petition.

5. (5) A. Admits that under the terms of said lease the Republic Steel Company was required to pay royalties; denies the remaining allegations contained in subparagraph (5) A of paragraph 5 of the petition.

5. (5) B to E, inclusive. Denies the allegations contained in sub-paragraphs (5) B to (5) E, inclusive, of paragraph 5 of the petition.

5. (6) Admits that the Republic Steel Company entered into possession of the mine in 1929; admits that it paid royalties under its lease, of which the decedent received a share; admits that the decedent claimed and was allowed depletion deductions in her Federal income tax returns for the years 1929 to 1936, inclusive, in respect of said royalties; denies the remaining allegations contained in subparagraph (6) of paragraph 5 of the petition.

5. (7) and (8). Admits the allegations contained in sub-paragraphs (7) and (8) of paragraph 5 of the petition.

5. (9) to (13), inclusive. Denies the allegations contained in subparagraphs (9) to (13), inclusive, of paragraph 5 of the petition.

5. (14). Admits the allegations contained in subparagraph (14) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation contained in the petition not hereinbefore specifically admitted, qualified or denied.

7. The facts upon which the respondent relies to sustain the determination that the petitioner is liable as transferee of the assets of the Estate of Irene B. Robinson Cirkler, Deceased, are as follows:

(1) The deficiency of $5,412.47 in Federal income tax and interest thereon determined to be due from the Estate of Irene B. Robinson Cirkler, Deceased, John S. Dalrymple,

Executor, and asserted herein against the petitioner as transferee, has not been paid.

[fol. 38] (2) The petitioner was a legatee under the last will and testament of Irene B. Robinson Cirkler, Deceased.

(3) As such legatee, and subsequent to the accrual of the tax liability in question, the petitioner received without consideration in the distribution of the Estate of Irene B. Robinson Cirkler, Deceased, assets of a value in excess of the said tax liability, together with interest thereon.

(4) As a result of said distribution of the assets to the petitioner, the Estate of Irene B. Robinson Cirkler, Deceased, became and ever since has been insolvent and without any assets with which to satisfy the payment of the taxes in controversy.

Wherefore, respondent prays that the Board redetermine the petitioner's liability herein to be the amount determined by the Commissioner, viz.: $5,412.47, plus interest as provided by law.

J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

Of counsel: F. R. Shearer, Division Counsel; S. U. Hiken, Special Attorney, Bureau of Internal Revenue.

BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

REPLY OF BERNICE B. DALRYMPLE TO ANSWER OF COMMISSIONER OF INTERNAL REVENUE IN CASE NO. 106705—Received and Filed May 2, 1941

Now comes the petitioner by her attorneys, James E. O'Brien and Kimball B. DeVoy, and for her reply to the [fol. 39] answer of the Commissioner filed herein admits as follows:

1. Admits each and every allegation contained in paragraphs 7(1), 7(2), 7(3) and 7(4) of said answer.

Wherefore, Petitioner prays that the Board redetermine her liability herein as prayed for in her petition.

James E. O'Brien, Kimball B. DeVoy, Attorneys for Petitioner, 808 First National-Soo Line Building, Minneapolis, Minnesota.

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 102870

[Titles omitted]

STIPULATION OF FACTS—Filed at Hearing June 16, 1941

It is hereby stipulated and agreed by and between the parties hereto, by their respective counsel, that the facts hereinafter set forth shall be taken as true, provided, however, (1) that each of the parties hereto reserves the right [fol. 40] to object to the admissibility in evidence of any of such facts, on the ground of irrelevancy and immateriality, and (2) that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be true.

A. The following facts apply to all of these proceedings:

1. Prior to 1929 Bessie P. Douglas, Adeline R. Morse, Charles H. Robinson and Irene B. Robinson Cirkler (sometimes hereinafter referred to as the Lessors) owned an iron ore mine situated in St. Louis County, Minnesota, known as the "Pettit" mine. Bessie P. Douglas owned an undivided one-half interest in the mine and each of the other Lessors owned an undivided one-sixth interest therein.

2. In 1929 the Lessors leased said mine to the Republic Steel Company of Youngstown, Ohio (hereinafter referred to as the Lessee), for a term of thirty (30) years commencing July 1, 1929. A copy of said lease and a copy of the only amendment thereto (hereinafter referred to as the lease) are attached hereto, marked Exhibit A, and made a part hereof the same as if fully set forth herein.

3. Pursuant to the provisions of the lease, and in accordance with its terms, the Lessee cancelled and terminated the lease in 1937, effective as of July 1 of that year.

4. No ore was removed from the Pettit mine at any time during the existence of the lease. Prior to the execution of the lease some iron ore had been removed.

B. The following facts, to the extent that they are relevant and material, apply to the case of Bessie P. Douglas, Docket No. 102870:

5. The petitioner, a resident of Minneapolis, Minnesota, filed her Federal income tax return for the year involved herein with the Collector of Internal Revenue for the District of Minnesota, at St. Paul, Minnesota.

6. In accordance with the provisions of the lease, the Lessee paid to the petitioner, as one of the Lessors of the Pettit mine, the following advance or minimum royalties [fol. 41] on mineral not removed, for the year 1929 to 1936, inclusive:

Year	Advance Royalties paid to and received by petitioner
1929	$2,500.00
1930	10,000.00
1931	10,000.00
1932	10,000.00
1933	10,000.00
1934	12,500.00
1935	22,500.00
1936	30,000.00

7. For said years the petitioner claimed depletion deductions in her Federal income tax returns on account of said advance royalties, which were allowed by the respondent as deductions, as follows:

Year	Depletion Deductions Claimed by Petitioner and Allowed by Respondent
1929	$1,239.51
1930	4,958.05
1931	4,958.05
1932	4,958.05
1933	4,958.05
1934	6,197.56
1935	11,155.61
1936	14,874.15

These depletion deductions were taken on the cost basis.

8. No income was reported by the petitioner in her Federal income tax return for 1937 on account of the depletion deductions claimed by and allowed to the petitioner for prior years on advance royalties from the Pettit mine.

9. For each of the taxable years 1929 to 1936, inclusive, the petitioner's net income and her Federal income

tax liability as finally adjusted and assessed by the respondent were as follows:

Year	Net Income	Income Tax Liability
1929	$105,823.88	$14,778.78
1930	41,892.00	3,131.04
1931	31,257.44	1,666.33
1932	25,390.96	2,099.69
1933	(13,947.51)*	None
1934	3,160.10	None
1935	15,226.09	672.14
1936	19,801.68	1,597.90

* Net loss.

[fol. 42] 10. In the computation of her income tax liability for 1934 the petitioner claimed and was allowed a dividend received credit of $5,894.05 and an earned income credit of $300.00.

11. If petitioner had not taken any deductions for depletion with respect to royalties received from the Pettit mine in the taxable years 1929 to 1936, inclusive, her net income and her income tax liability for each of said years would have been as follows:

Year	Net Income	Income Tax Liability
1929	$107,063.39	$15,076.26
1930	46,850.05	3,952.83
1931	35,471.79	2,248.92
1932	29,605.30	2,910.38
1933	(8,989.46)*	None
1934	8,428.03	295.04
1935	25,028.66	2,216.03
1936	32,444.71	4,169.93

* Net loss.

12. The petitioner concedes the correctness of the following adjustments which are set forth in the statement attached to the deficiency notice from which the appeal herein was taken;

"Unallowable deductions and additional income:

"(a) Adjustment of depletion Corsica Mine	$4,031.14
"(b) Depletion disallowed on Pettit Mine	7,437.08
"(d) Cost of preparation of return	125.00"
Total	$11,593.22

* * * * * * *

D. The following facts, to the extent that they are relevant and material, apply to the case of Estate of Charles H. Robinson, Northwestern National Bank and Trust Company of Minneapolis, Jessie P. Robinson and Charles J. Robinson, Co-Executors, Docket No. 102,869:

20. Charles H. Robinson died August 16, 1932. His estate (hereinafter referred to as the petition) is being and at all times since his death has been administered by the Co-Executors thereof, who filed a Federal income tax [fol. 43] return for the period involved herein with the Collector of Internal Revenue for the District of Minnesota, at St. Paul, Minnesota.

21. In accordance with the provisions of the lease, the Lessee paid to the petitioner, as one of the Lessors by succession of the Pettit mine, the following advance or minimum royalties on mineral not removed, for the period in 1932 following Charles H. Robinson's death and for the years 1933 to 1936, inclusive:

Year	Advance Royalties Paid to and Received by Petitioner
Aug. 16 to Dec. 31, 1932	$ 833.33
1933	3,333.32
1934	4,166.66
1935	7,500.00
1936	10,000.00

22. The petitioner did not file a Federal income tax return for the taxable year 1932 covering the period from August 16 to December 31, inclusive. Its taxable net income for said period, after taking a depletion deduction of $413.19 on account of said advance royalties, was $620.87 and it was entitled to a personal exemption credit of $1,000. Said depletion deduction of $413.19 was entered in petitioner's books for said period, and was allowed by the re-

spondent in his examination of the petitioner's Federal income tax liability for said period.

23. For the years 1933 to 1936, inclusive, the petitioner claimed depletion deductions in its Federal income tax returns on account of advance royalties on the Pettit mine, which were allowed as deductions by the respondent, as follows:

Year	Depletion Deductions Claimed by Petitioner and Allowed by Respondent
1933	$1,176.00
1934	2,065.94
1935	2,646.01
1936	3,528.00

These depletion deductions were taken on the cost basis.

24. No income was reported by the petitioner in its Federal income tax return for 1937 on account of the deple-
[fol. 44] tion deductions claimed by and allowed to the petitioner for prior years on advance royalties from the Pettit mine.

25. For the period August 16 to December 31, 1932, and for each of the taxable years 1933 to 1936, inclusive, the petitioner's net income and its Federal income tax liability as adjusted and assessed by the respondent were as follows:

Year	Net Income	Income Tax Liability
Aug. 16 to Dec. 31, 1932	$ 620.87	None
1933	1,934.68	$ 37.35
1934	3,086.11	83.06
1935	9,732.88	572.68
1936	8,589.11	463.02

26. If petitioner had not taken any deductions for depletion with respect to royalties received from the Pettit mine for the period August 16 to December 31, 1932, and for the taxable years 1933 to 1936, inclusive, its net income and its income tax liability for each of said years would have been as follows:

Year	Net Income	Income Tax Liability
Aug. 16 to Dec. 31, 1932	$ 1,034.06	$ 1.36
1933	3,110.68	84.39
1934	5,152.05	171.78
1935	12,378.89	851.07
1936	12,117.11	822.88

27. The parties hereto concede the correctness of the following adjustments which are set forth in the statement attached to the deficiency notice from which the appeal herein was taken:

"Unallowable deductions and additional income:

"(a) To disallow depletion on Pettit Mine $1,724.00

"Nontaxable income and additional deductions:

"(c) To adjust depletion on Corsica Mine 1,993.01"

E. The following facts, to the extent that they are relevant and material, apply to the case of Bernice B. Dalrymple, Docket No. 106,705:

28. The petitioner, a resident of Minneapolis, Minnesota, is the transferee of the assets of the Estate of Irene B. Robinson Cirkler, deceased. Irene B. Robinson Cirkler [fol. 45] (hereinafter referred to as the decedent) was, prior to her death on October 20, 1937, a resident of Hollywood, California. The decedent's Federal income tax return for the period involved herein was filed with the Collector of Internal Revenue for the District of Minnesota, at St. Paul, Minnesota.

29. In accordance with the provisions of the lease, the Lessee paid to the decedent, as one of the Lessors of the Pettit Mine, the following advance or minimum royalties on mineral not removed, for the years 1929 to 1936, inclusive:

Year	Advance Royalties Paid to and Received by Decedent
1929	$ 833.33
1930	3,333.33
1931	3,333.33
1932	3,333.33
1933	3,333.33
1934	5,000.00
1935	7,500.00
1936	10,000.00

30. For said years the decedent claimed depletion deductions in her Federal income tax returns on account of

said advance royalties, which were allowed by the respondent as deductions, as follows:

Year	Depletion Deductions Claimed by Decedent and Allowed by Respondent
1929	$ 413.19
1930	1,652.75
1931	1,652.75
1932	1,652.75
1933	1,652.75
1934	2,479.13
1935	3,718.69
1936	4,958.25

These depletion deductions were taken on the cost basis.

31. No income was reported by the decedent in her Federal income tax return for 1937 following the termination of the lease on account of the depletion deductions claimed by and allowed to the decedent for prior years on advance royalties from the Pettit mine.

32. For each of the taxable years 1929 to 1936, inclusive, the decedent's net income and her Federal income tax [fol. 46] liability as finally adjusted and assessed by the respondent were as follows:

Year	Net Income	Income Tax Liability
1929	$43,789.21	$3,606.51
1930	17,601.06	699.96
1931	15,761.59	555.19
1932	14,991.60	1,139.00
1933	1,591.03	23.64
1934	2,087.46	35.15
1935	5,254.50	168.36
1936	11,651.80	759.70

33. If decedent had not taken any deductions for depletion with respect to royalties received from the Pettit mine in the taxable years 1929 to 1936, inclusive, her net income and her income tax liability for each of said years would have been as follows:

Year	Net Income	Income Tax Liability
1929	$44,202.40	$3,670.52
1930	19,253.81	844.72
1931	17,414.34	685.03

Year	Net Income	Income Tax Liability
1932	16,644.35	1,343.77
1933	3,243.78	89.75
1934	4,566.59	130.66
1935	8,973.19	485.59
1936	16,610.05	1,357.30

34. The petitioner concedes the correctness of the following adjustment to the decedent's taxable net income which is set forth in the statement attached to the deficiency notice from which the appeal herein was taken:

"Unallowable deductions and additional income:

(a) Depletion disallowed on Pettit Mine . $5,371.44"

James E. O'Brien, Kimball B. DeVoy, Counsel for Petitioner, 808 First National-Soo Line Building, Minneapolis, Minnesota. J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

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* * * * * * *

[fol. 47] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

Docket Nos. 120,869, 120,870, 120,871 & 106,705

EXCERPT FROM TRANSCRIPT OF HEARING—June 16, 1941

* * * * * * *

Mr. DeVoy: Well, one additional stipulation and fact that it was agreed between Counsel for the respondent and myself that we would like to have written into the record.

The Member: That may be done.

Mr. DeVoy: Do you want this subject to your right to object on the grounds of immateriality?

Mr. Hiken: No, it may be stipulated as a fact.

Mr. DeVoy: It is stipulated as an additional fact that for each of the taxable years, 1925 to 1937, inclusive, Bessie P. Douglas, Adeline R. Morse, and Irene B. Robinson, for each of the taxable years, 1932 to 1937, inclusive, and the Estate of Charles H. Robinson reported their income and claimed their deductions on a cash basis.

The Member: Let the record show that stipulation.

* * * * * * *

BEFORE UNITED STATES BOARD OF TAX APPEALS

Estate of CHARLES H. ROBINSON, Northwestern National Bank and Trust Company of Minneapolis, Jessie P. Robinson and Charles J. Robinson, Co-executors, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

BESSIE P. DOUGLAS, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

[fol. 48] Estate of ADELINE R. MORSE, Deceased, John S. Dalrymple, Executor, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

BERNICE B. DALRYMPLE, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 102869, 102870, 102871, 106705. Promulgated April 14, 1942

In computing the net income of the taxpayers for 1937 the respondent included in gross income the amount of the depletion deductions taken and allowed in prior years with respect to minimum royalties received in such years under a mineral lease which was terminated in 1937 by the lessee without any ore having been extracted. Held, that the respondent's action was correct in the case of each of the taxpayers, except that in the case of Bessie P. Douglas the amount so included is to be reduced to the extent that it represented a deduction which did not effect an offset of taxable income for the year in which taken and allowed.

Kimball B. DeVoy, Esq., for the petitioners.

S. U. Hiken, Esq., for the respondent.

OPINION

Turner: The Commissioner determined deficiencies in income tax as follows:

	Docket No.	Year	Deficiency
Estate of Charles H. Robinson	102869	1937	$1,532.38
Bessie P. Douglas	102870	1937	30,024.60
Estate of Adeline R. Morse	102871	1937	4,426.63
		1938	297.02

The Commissioner also determined a deficiency of $5,412.47 in the income tax of Irene B. Robinson Cirkler for the period January 1 to October 20, 1937, the date of her death, and proposed to assess said amount plus interest against Bernice B. Dalrymple, petitioner in Docket No. 106705, as a transferee of assets of the estate of Irene B. Robinson Cirkler, deceased.

[fol. 49] The issues presented by the pleadings are (1) whether the owners of an iron ore property are entitled to a deduction for depletion in 1937 with respect to minimum royalties received in that year, the lease under which the royalties were paid having been terminated in that year without any ore having been removed from the property during the life of the lease, (2) whether in determining taxable income for 1937 there is to be included the amounts of the depletion deductions taken by said owners in prior years in respect to the above lease, and, if said amounts of depletion are to be included in taxable income for 1937, whether they are first to be reduced by the portions thereof as to which no tax benefit was obtained in the years in which deducted, and (3) in the case of the estate of Adeline R. Morse, deceased, whether there is to be allowed a deduction for depletion taken in 1938 with respect to royalties received in that year from the above mentioned lease. The petitioners have conceded the correctness of respondent's disallowance of the deductions involved in issues (1) and (3), thus leaving for determination only the issue presented in (2).

With the exception of the facts relating to the liability of Bernice B. Dalrymple as transferee, all of which were alleged and admitted in the pleadings, the proceedings were submitted on stipulation of facts, which we adopt herein as part of our findings of fact. Such of the stipu-

lated facts and of those shown by the pleadings as we deem necessary for a discussion of the issue here involved are set out below.

The income tax returns of the estate of Charles H. Robinson, Bessie P. Douglas, and Irene B. Robinson Cirkler for the year 1937 or the period here involved and the returns for 1937 and 1938 of Adeline R. Morse were filed with the collector of internal revenue for the district of Minnesota.

On July 1, 1929, as well as prior thereto, the four petitioners or their predecessors in title were owners of an iron mine situated in the State of Minnesota, known as the Pettit Mine, from which some iron ore had been removed. Bessie [fol. 50] P. Douglas owned an undivided one-half interest in the mine and each of the others owned an undivided one-sixth interest.

On July 1, 1929, the four owners leased the mine to the Republic Steel Corporation for a term of 30 years commencing on that date. The lease provided that minimum royalties should be paid annually whether any ore was extracted during the year or not. Minimum royalties paid in advance of extraction of ore were to be applied on ore later mined and shipped. The lease also provided for its cancellation by the lessee, after a specified period, upon three months written notice to the lessors. As of July 1, 1937, the lessee, pursuant to the terms thereof, canceled and terminated the lease without having removed any ore from the mine during the existence of the lease.

From the date of the execution of the lease until its termination the lessee paid the agreed advance royalties to the lessors or their respective successors. Said lessors or successors in filing their income tax returns, which were prepared on the cash basis, reported in their gross incomes for the respective years the royalties received in such years and took deductions for depletion with respect to such royalties. The depletion deductions thus taken were computed on the cost basis and were allowed by the respondent.

In determining the deficiencies herein involved for the year 1937 the respondent, pursuant to the provisions of paragraph (c) of article 23 (m)-10 of Regulations 94, relating to the Revenue Act of 1936, included the following

indicated amounts in the taxable income of the respective taxpayers:

Estate of Charles H. Robinson	$9,829.14
Bessie P. Douglas	53,299.03
Adeline R. Morse	18,180.26
Irene B. Robinson Cirkler	18,180.26

The foregoing amounts represent the total of the depletion deductions claimed by and allowed to said taxpayers for the years prior to and including 1936 with respect to the minimum royalties received by them from the lease on the Pettit Mine.

[fol. 51] The petitioners contend that the respondent's action was erroneous and that in the redetermination of their respective tax liabilities for 1937 there should be eliminated from income the amounts included therein by the respondent on account of depletion deductions taken in prior years. The respondent maintains that his action was correct and proper.

Regulations 94 provides as follows:

Art. 23 (m)-10. Depletion—Adjustments of accounts based on bonus or advanced royalty.—

* * * * * * *

(b) If the owner has leased a mineral property for a term of years with a requirement in the lease that the lessee shall extract and pay for, annually, a specified number of tons, or other agreed units of measurement, of such mineral, or shall pay, annually, a specified sum of money which shall be applied in payment of the purchase price or royalty per unit of such mineral whenever the same shall thereafter be extracted and removed from the leased premises, an amount equal to that part of the basis for depletion allocable to the number of units so paid for in advance of extraction will constitute an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by the lessor shall be claimed or allowed in any subsequent year on account of the extraction or removal in such year of any mineral so paid for in advance and for which deduction has once been made.

(c) If for any reason any such mineral lease expires or terminates or is abandoned before the mineral which has

been paid for in advance has been extracted and removed, the lessor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed; and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned.

In support of their contention the petitioners urge that the application of paragraph (c) of article 23 (m)-10, supra, to their cases imposes upon them a severe penalty without [fol. 52] justification. Taking the case of Bessie P. Douglas as illustrative, they state that by taking depletion deductions totaling $53,299.03 over the eight-year period, 1929 through 1936, she reduced her total income tax liability for that period by $6,923.51; that by including said $53,299.03 in income for 1937 her tax liability for that year is $26,550.65 in excess of what it was without such inclusion or approximately $20,000 more than the reduction effected by reason of the depletion deductions taken in prior years. They insist that such a result is violative of the provisions of section 23 (m) of the Revenue Act of 1936 and similar sections of prior acts allowing deduction of "a reasonable allowance" for depletion since in reality it works a denial to the taxpayers of such allowance. They contend that we should declare paragraph (c) of article 23 (m)-10, as applied to these cases, to be invalid and unauthorized by the act. As alternative procedures to that contained in said paragraph (c), the petitioners suggest the following, both of which it is claimed would protect the collection of taxes and not unjustly burden the taxpayers: (1) Permit matters to stand as they were at the termination of the lease, thereby leaving the lowered cost as the taxpayers' basis for depletion with respect to future leases or production, or (2) provide that as a condition precedent to the allowance in any year of a depletion deduction with respect to royalties received prior to the extraction of mineral, the taxpayer be required to waive the period of limitations for such year and that when the lease is terminated without any extraction of mineral the taxpayers' tax liability be redetermined for the years in which depletion deductions were taken by disallowing such deductions and recomputing the tax liability on the basis of the tax rates in effect for the respective years.

As was pointed out in Grace M. Barnett, 39 B. T. A. 864, arising under the Revenue Act of 1934 and involving paragraph (c) of article 23(m)-10 of Regulations 86, all of the regulations, beginning with Regulations 45, relating to the Revenue Act of 1918, have provided that if depletion is allowed with respect to an advance royalty or bonus and no production occurs during the life of the lease, the lessor must restore to his capital account and report as income in [fol. 53] the year the lease terminates the amount he has been allowed to deduct as depletion in connection with the advance payment, and that that method of allowing and adjusting deductions for depletion had been considered and in effect approved by the Supreme Court in Murphy Oil Co. vs. Burnet, 287 U. S. 299. That method was followed by us in the Barnett case and was applied in Sneed vs. Commissioner, 119 Fed. (2d) 767; rehearing denied, 121 Fed. (2d) 725; certiorari denied, — U. S. — (Nov. 17, 1941), affirming 40 B. T. A. 1136; Crabb vs. Commissioner, 119 Fed. (2d) 772, affirming 41 B. T. A. 686; and Lamont vs. Commissioner, 120 Fed. (2d) 996. These cases are applicable in the instant proceedings and effectively dispose of the main contention of the petitioners.

It is to be observed that the hardship here complained of does not result entirely from the method set forth in the Commissioner's regulation but results in part from the fact that income tax rates were increased over the period 1929 to 1937 and the depletion deductions were taken, generally speaking, in years in which the incomes of the taxpayers were at comparatively low levels. Doubtless, there are cases where the taxpayers had high incomes during the years in which depletion deductions were taken but low incomes for the year in which the deductions are included in income and who would therefore pay less tax under the method contained in the regulations than if the deductions were disallowed for the years in which they were taken. The next case coming before us may present just such a situation. The mere fact that due to his peculiar circumstances one taxpayer may, under the method contained in the regulations, effect a net saving in tax while another taxpayer differently circumstanced may pay more tax than he otherwise would, is not a sufficient reason for holding the method to be invalid in its application here. The uni-

formity required of tax laws is geographic uniformity, not intrinsic uniformity. Bromley vs. McCaughn, 280 U. S. 124.

For the years 1933 and 1934 Bessie P. Douglas took and was allowed depletion deductions of $4,958.05 and $6,197.56, respectively, with respect to the minimum royalties received in those years from the lease on the Pettit Mine. Her net income or loss (after allowance of said deductions) and her income tax liability for said years as finally determined and assessed by respondent were as follows:
[fol. 54]

	Net loss	Net income	Income tax liability
1933	$13,947.51		none
1934		$3,160.10	none

In the computation of her income tax liability for 1934 she claimed and was allowed a dividends received credit of $5,894.05 and an earned income credit of $300.

For the period August 16 to December 31, 1932, the net income of the estate of Charles H. Robinson was $620.87 after allowance of depletion of $413.19 on account of minimum royalties received in that period from the lease on the Pettit Mine. The estate was entitled to a personal exemption credit of $1,000.

With respect to Bessie P. Douglas, it is contended that the respondent erred in including in her 1937 income the amount of $4,958.05 representing the depletion deduction taken by her in 1933. It is also contended that the respondent erroneously included in income $839.90 of the depletion deduction taken by her for 1934. Said amount of $839.90 represents the difference between her net income of $3,160.10 for 1934 and $4,000, the amount above which her income was subject to surtax under the Revenue Act of 1934. With respect to the estate of Charles H. Robinson, it is contended that the respondent erroneously included in 1937 income $379.13 of the depletion allowance for the period August 16 to December 31, 1932. Said amount of $379.13 represents the difference between the net income of $620.87 and $1,000, the amount of the personal exemption credit. It is accordingly urged that the deductions in the amounts of $4,958.05 and $839.90 in the case of Bessie P. Douglas and $379.13 in the case of the estate of Charles H. Robinson produced no "tax benefit" and that the said

amounts should not therefore be included in their 1937 income.

The respondent, relying on Beckridge Corporation, 45 B. T. A. 131, on appeal to the Circuit Court of Appeals for [fol. 55] the Second Circuit, contends that the full amount should be included in 1937 income, regardless of "tax benefit" in the years of deduction. In that case the taxpayer, in 1931, acquired certain real estate which it sold in 1937. During the period of ownership there was actual depreciation of the property, but the taxpayer, operating at a net loss during each of the years, took no deduction for such depreciation either on its books or on its income tax returns. The question presented was whether, for the purpose of computing gain or loss on the sale, the cost basis of the property was to be reduced on account of depreciation occurring during the period of ownership. We there considered the rule of United States vs. Ludey, 274 U. S. 295, and other related cases, which is to the effect that when a taxpayer sells a depreciable property after years of use, the property sold is not the original property but the original property reduced by the depreciation sustained thereon, and that accordingly depreciation must be deducted from the original cost in order to determine the cost of what was disposed of by the sale. In accordance with that rule and the pertinent provisions of the applicable act, we held that the cost basis of the property sold by the Beckridge Corporation was to be reduced by the depreciation allowable with respect to the property during the period of ownership by the corporation.

We fail to see wherein our decision in Beckridge Corporation, supra, is controlling here. In urging the applicability of that decision here the respondent assumes a position contradictory to that taken on the first issue herein. In the instant cases no property was sold nor was any depletion actually sustained. The lessors merely took and were allowed certain deductions for depletion which it was anticipated they would sustain. Upon termination of the lease in 1937, no ore having been extracted, it was found that the anticipated depletion had not been sustained and never would be sustained. The respondent thereupon included in income for 1937 the depletion deductions allowed in prior years, thereby in effect determining that the deductions so allowed were not in fact allowable deductions. Cf. Kennedy Laundry Co., 46 B. T. A. 70.

In support of their claim the petitioners rely on Central Loan & Investment Co., 39 B. T. A. 981; and Amsco-Wire [fol. 56] Products Corporation, 44 B. T. A. 717. In Estate of James N. Collins, 46 B. T. A.—(March 27, 1942), and John V. Dobson, 46 B. T. A.—(March 27, 1942), we had occasion to review the decisions relied on by the petitioners herein and, in the case of John V. Dobson, said:

Where there is recovery in respect of a loss sustained in an earlier year and a deduction of such loss claimed and allowed for the earlier year had effected an offset in taxable income, the amount recovered in the later year should be included in taxable income for the year of recovery, the reason being that even though the subsequent recovery is in the nature of a capital recovery the prior deduction of the amount of the loss from taxable income has for income tax purposes already given the taxpayer a recoupment of said loss out of taxable income and the subsequent recovery, being in the nature of a replacement of taxable income, is equivalent to gain to the taxpayer. National Bank of Commerce of Seattle vs. Commissioner, 115 Fed. (2d) 875, affirming 40 B. T. A. 72. But where the deduction claimed and allowed in the prior year did not effect an offset of taxable income, the amount recovered in a later year does not constitute taxable income for the year of recovery. Estate of James N. Collins, supra.

Applying the rule to the case of Bessie P. Douglas, who had a net loss of $13,947.51 for 1933, it is apparent that the depletion deduction of $4,958.05 taken in that year did not effect an offset in taxable income, since she had a net loss for that year of $8,989.46 aside from the depletion deduction. Accordingly we hold that the respondent erred in including said $4,958.05 in income for 1937.

After taking a depletion deduction of $6,197.56 in 1934, Bessie P. Douglas still had a net income of $3,160.10 for that year; likewise the estate of Charles H. Robinson still had net income of $620.87 for the period August 16 to December 31, 1932, after the allowance of depletion in the amount of $431.19. From this it is clear that the entire amount of said depletion allowances effected offsets in the income of these taxpayers for the taxable periods mentioned and are to be included in income for the year in which the lease was canceled. John V. Dobson, supra; Cen- [fol. 57] tral Loan & Investment Co., supra; National Bank

of Commerce of Seattle, 40 B. T. A. 72; affd., 115 Fed. (2d) 875; and Amsco-Wire Products Corporation, supra.

The respondent's action in including in taxable income for 1937 the depletion deductions taken and allowed in prior years is sustained in all the cases involved in these proceedings except as to $4,958.05 in the case of Bessie P. Douglas.

It is stipulated that Bernice B. Dalrymple is transferee of assets of the estate of Irene B. Robinson Cirkler, deceased, and the pleadings establish the extent to which she may be so held.

Decisions will be entered under Rule 50.

BEFORE UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 102,870

BESSIE P. DOUGLAS, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

ORDER OF REDETERMINATION—May 9, 1942

Pursuant to the opinion of the Board promulgated April 14, 1942, the respondent on April 27, 1942 filed a recomputation of tax and the petitioner on May 7, 1942 filed an agreement to such recomputation. Now, therefore, it is

Ordered and Decided: That there is a deficiency in income tax for the calendar year 1937 in the amount of $26,977.56.

Enter:

Entered: May 9, 1942.

Bolon B. Turner, Member.

(Seal, U. S. Board of Tax Appeals, 1924.)

[fol. 58] BEFORE UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 102,869

ESTATE OF CHARLES H. ROBINSON, NORTHWESTERN NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, Jessie P. Robinson and Charles J. Robinson, Co-Executors, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

ORDER OF REDETERMINATION—May 9, 1942

Pursuant to the opinion of the Board promulgated April 14, 1942, the respondent herein on April 29, 1942 filed a recomputation of tax and the petitioner on May 7, 1942, filed an agreement to such recomputation. Now, therefore, it is

Ordered and Decided: That there is a deficiency in income tax for the calendar year 1937 in the amount of $1,532.38.

Enter:

Entered: May 9, 1942.

Bolon B. Turner, Member.

(Seal, U. S. Board of Tax Appeals, 1924.)

BEFORE UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 106,705

BERNICE B. DALRYMPLE, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

ORDER OF REDETERMINATION—May 9, 1942

Pursuant to the opinion of the Board promulgated April 14, 1942, the respondent herein on April 29, 1942 filed a recomputation of tax and on May 7, 1942 petitioner filed an agreement to such recomputation. Now, therefore, it is

[fol. 59] Ordered and Decided: That at law and in equity

there is an unpaid liability for income tax in the amount of $5,412.47, together with interest as provided by law, for the period January 1 to October 20, 1937, due from this petitioner as transferee of the assets of Irene B. Robinson Cirkler, deceased.

Enter:

Entered: May 9, 1942.

Bolon B. Turner, Member.

(Seal, U. S. Board of Tax Appeals, 1924.)

IN UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT

[Title omitted]

PETITION OF BESSIE P. DOUGLAS IN CASE NO. 102870 FOR REVIEW OF DECISION OF UNITED STATES BOARD OF TAX APPEALS—Filed August 3, 1942

To: The Honorable, The Judges Of The United States Circuit Court Of Appeals For the Eighth Circuit:

Bessie P. Douglas, the petitioner in the above entitled matter, by James E. O'Brien and Kimball B. DeVoy, her counsel, hereby files her petition for a review by the United States Ci-cuit Court of Appeals for the Eighth Circuit of the decision by the United States Board of Tax Appeals rendered on May 9, 1940, 46 B. T. A. , No. 125, determining a deficiency in the petitioner's Federal income tax for the calendar year 1937, in the amount of $26,977.56, and respectfully shows:

I.

JURISDICTION

The petitioner, Bessie P. Douglas, at the time of filing this petition, is an individual, a citizen of the United States, and resides at 2424 Park Avenue, Minneapolis, Minnesota. [fol. 60] She filed her Federal Income Tax return for the year 1937, the period here involved, at the office of the Collector of Internal Revenue for the District of Minnesota, in St. Paul, Minnesota, which is located within the juris-

diction of the United States Circuit Court of Appeals for the Eighth Circuit. Subsequent to the decision of the Board, review of which is herein sought, petitioner paid in full the deficiency thereby determined, together with interest thereon as provided by law, to the date of said payment.

II

Nature of the Controversy

The controversy involves the propriety of cumulating income received by a cash-basis taxpayer in each of a series of eight years, adding the accumulated total to the gross income of the ninth year, and assessing the tax thereon at progressive rates for the ninth year.

The facts giving rise to this controversy are substantially as follows:

Prior to 1929 Bessie P. Douglas, Adeline R. Morse, Charles H. Robinson and Irene B. Robinson Cirkler, were the owners of the Pettit iron mine in St. Louis County, Minnesota. Bessie P. Douglas, this petitioner, owned an undivided one-half interest and each of the other owners owned an undivided one-sixth interest. In 1929 these owners leased the mine to the Republic Steel Company for a term of thirty (30) years commencing July 1, 1929.

In each of the years 1929 to 1936, inclusive, Bessie P. Douglas received certain advance or minimum royalties. For each of these years she claimed depletion deductions in her Federal income tax returns on account of said advance royalties. These depletion deductions were taken on the cost basis and were allowed by the respondent as proper deductions.

As of July 1, 1937, pursuant to the provisions of the lease, the Lessee cancelled and terminated the lease. No ore had been removed from the mine at any time during the existence of the lease.

[fol. 61] In her Federal income tax return for 1937, petitioner reported no income by reason of the depletion deductions allowed to her for the years 1929 to 1936, inclusive.

Upon audit of petitioner's return for 1937, the respondent added to the gross income reported therein an amount equal to the aggregate of the deductions for depletion taken by

her on each of her returns for the eight years, 1929 through 1936, and based his determination of the deficiency upon this addition. The respondent made this addition pursuant to Article 23m—10(e) of Regulations 94. The Board held that the Commissioner erred in including the depletion deduction taken by petitioner for the year 1933 in which petitioner sustained a large net loss without the aid of the depletion deduction. Otherwise the Board sustained the action of the Commissioner in adding these amounts to petitioner's income for the year 1937.

Petitioner's position was and is that the inclusion of any of these amounts in the 1937 gross income constitutes an unlawful cumulation into one year of income received by her in a series of years.

III

Petitioner, being aggrieved by the conclusions of law contained in the opinion of the Board and by its decision entered pursuant thereto, desires to obtain a review thereof by the United States Circuit Court of Appeals for the Eighth Circuit.

IV

Assignments of Error

The petitioner assigns as error the following acts of the Board of Tax Appeals:

1. The Board erred in holding as a conclusion of law that it was proper to include in the petitioner's gross income for the year 1937 $839.90 of the depletion deduction taken by her for the year 1934.

2. The Board erred in holding as a conclusion of law that it was proper to include in petitioner's gross income for the year 1937 an amount equal to the aggregate of the depletion deductions taken by petitioner and allowed by the [fol. 62] respondent for each of the years 1929 to 1936, inclusive, with the exception of the year 1933.

3. The Board erred in failing to hold as a conclusion of law that it was improper to include in the gross income for 1937 any amount based upon depletion deductions taken by petitioner and allowed by the respondent for any of the years 1929 to 1936, inclusive.

Wherefore, Petitioner petitions that the aforesaid decision of the Board be reviewed and that the errors of said decision be corrected by appropriate action of this Court.

Dated: July 29th, 1942.

James E. O'Brien & Kimball B. DeVoy, Counsel for Petitioner, 808 First National-Soo Line Bldg., Minneapolis, Minnesota.

Duly sworn to by James E. O'Brien and Kimball B. DeVoy. Jurats omitted in printing.

[fol. 63] IN UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted]

NOTICE OF FILING OF PETITION FOR REVIEW BY BESSIE P. DOUGLAS IN CASE NO. 102870 AND ACKNOWLEDGMENT OF SERVICE—Filed August 3, 1942

To: John P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Washington, D. C.

Please take notice that the petitioner on the 3rd day of August, 1942, filed with the Clerk of the United States Board of Tax Appeals at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit of the decision of the Board heretofore rendered in the above entitled cause, a copy of which petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 29th day of July, 1942 at Minneapolis, Minnesota.

Respectfully, James E. O'Brien & Kimball B. DeVoy, Counsel for Petitioner, 808 First National-Soo Line Bldg., Minneapolis, Minnesota.

[fol. 64] Personal service of the foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 3rd day of August, 1942.

J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

In the United States Circuit Court of Appeals for the Eighth Circuit

[Title omitted]

Petition of Guy T. Helvering, Commissioner of Internal Revenue, in Case No. 102870 for Review of Decision of United States Board of Tax Appeals—Received and Filed August 7, 1942

To the Honorable Judges of the United States Circuit Court of Appeals for the Eighth Circuit:

Guy T. Helvering, Commissioner of Internal Revenue, holding office by virtue of the laws of the United States, hereby petitions the United States Circuit Court of Appeals for the Eighth Circuit to review the decision entered by the United States Board of Tax Appeals on May 9, 1942, ordering and deciding that there is a deficiency in income tax for the calendar year 1937 in the amount of $26,977.56 due from the taxpayer, Bessie P. Douglas, the respondent on review. The taxpayer's individual income tax return for the calendar year 1937 was filed with the Collector of Internal Revenue for the District of Minnesota, located at St. Paul, Minnesota.

The question presented is whether the Board erred in holding that the amount of $4,958.05 representing the depletion deduction claimed and allowed in 1933 on account of minimum royalties received from a mineral lease which was terminated in 1937 by the lessee without any ore having [fol. 65] been extracted, did not effect an offset in taxable income for 1933, since the taxpayer had a net loss for that year of $8,989.46 aside from the depletion deduction, and, therefore, the amount of the deduction may not be included in taxpayer's gross income for 1937. In his deficiency notice the Commissioner included in taxpayer's gross income for 1937 the amount of $53,290.03 representing the total of depletion deductions claimed by and allowed to the tax-payer for prior years with respect to minimum royalties received in such years from the mineral lease in question. The Board held that the Commissioner's action was correct except as to the amount of $4,958.05 representing the depletion deduction taken by the taxpayer in 1933. The Board said that the 1933 deduction did not effect an offset

of taxable income and, therefore, the Commissioner erred in including said $4,958.05 in income for 1937.

The Commissioner avers that in the record and proceedings before the United States Board of Tax Appeals and in the opinion and decision rendered and entered by the United States Board of Tax Appeals manifest error occurred and intervened to the prejudice of the Commissioner who now assigns the following points on which he intends to rely in this proceeding:

1. The United States Board of Tax Appeals erred in holding that the depletion deduction claimed and allowed in 1933 in the amount of $4,958.05 on account of minimum royalties received in that year from a mineral lease which was terminated in 1937 by the lessee without any ore having been extracted, did not effect an offset in taxable income for 1933 since taxpayer had a net loss for that year of $8,989.46 aside from the depletion deduction, and, therefore, the amount of the deduction may not be included in taxable income for 1937, and in overruling the Commissioner's determination in including said amount of $4,958.05 in taxpayer's 1937 income.

2. The United States Board of Tax Appeals erred in holding that there is a deficiency in income tax for the calendar year 1937 in the amount of only $26,977.56.

[fol. 66] 3. The United States Board of Tax Appeals erred in failing to hold that there is a deficiency in income tax for the calendar year 1937 in the amount of $30,024.60.

4. The United States Board of Tax Appeals erred in failing to hold that the sum of $4,958.05 representing the depletion deduction claimed and allowed in 1933 should be included in taxable income for 1937 whether or not taxpayer received a tax benefit from the deduction in 1933.

5. The United States Board of Tax Appeals erred in that its opinion and decision are contrary to its findings of fact.

6. The United States Board of Tax Appeals erred in that its opinion and decision are not supported by its findings of fact and are contrary to law.

Samuel O. Clark, Jr., Assistant Attorney General;
J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

[Title omitted]

NOTICE OF FILING OF PETITION FOR REVIEW BY GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, IN CASE NO. 102870, AND ACKNOWLEDGMENT OF SERVICE—Received and Filed August 18, 1942

To: Bessie P. Douglas, 2424 Park Avenue, Minneapolis, Minnesota.

You are hereby notified that the Commissioner of Internal Revenue did on the 7th day of August, 1942, file with [fol. 67] the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit, of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 7th day of August, 1942.

J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review mentioned therein, is hereby acknowledged this 11 day of Aug., 1942.

Bessie P. Douglas, Respondent on Review.

IN UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted]

PETITION OF ESTATE OF CHARLES H. ROBINSON, ET AL., CO-EXECUTORS, IN CASE NO. 102869 FOR REVIEW OF DECISION OF UNITED STATES BOARD OF TAX APPEALS.—Filed August 3, 1942.

* * * * * * *

To: The Honorable, The Judges of the United States Circuit Court of Appeals for the Eighth Circuit:

Northwestern National Bank and Trust Company of Minneapolis, Jessie P. Robinson and Charles J. Robinson,

Co-executors of the Estate of Charles H. Robinson, the petitioners in the above entitled matter, by James E. O'Brien and Kimball B. DeVoy, their counsel, hereby file their petition for a review by the United States Circuit [fol. 68] Court of Appeals for the Eighth Circuit of the decison by the United States Board of Tax Appeals rendered on May 9, 1940, 46 B. T. A., * * * No. 125, determining a deficiency in the petitioners' Federal Income Tax for the calendar year 1937, in the amount of $1,532.38, and respectfully show:

I.

JURISDICTION

The petitioner, Northwestern National Bank and Trust Company of Minneapolis, at the time of filing this petition is a national banking association organized under the laws of the United States, having its principal office and place of business at Minneapolis, Minnesota. The petitioners, Jessie P. Robinson and Charles J. Robinson, at the time of filing this petition are individuals, citizens of the United States and residents of Minneapolis, Minnesota. These three petitioners are and at all times material in this proceeding have been Co-executors of the Estate of Charles H. Robinson. They filed the Federal Income Tax return of said estate for the year 1937, the period here involved, at the office of the Collector of Internal Revenue for the District of Minnesota, in St. Paul, Minnesota, which is located within the jurisdiction of the United States Circuit Court of Appeals for the Eighth Circuit. Subsequent to the decision of the Board, review of which is herein sought, petitioners paid in full the deficiency thereby determined, together with interest thereon as provided by law to the date of said payment.

II

NATURE OF THE CONTROVERSY

The controversy involves the propriety of cumulating income received by a cash-basis taxpayer in each of a series of five years, adding the accumulated total to the gross income of the sixth year, and assessing the tax thereon at progressive rates for the sixth year.

The facts giving rise to this controvery are substantially as follows:

Prior to 1929 Charles H. Robinson, Bessie P. Douglas, Adeline R. Morse and Irene B. Robinson Cirkler, were the [fol. 69] owners of the Pettit iron mine in St. Louis County, Minnesota. Charles H. Robinson owned an undivided one-sixth interest in this property. In 1929 these owners leased the mine to the Republic Steel Company for a term of thirty (30) years commencing July 1, 1929.

Charles H. Robinson died on August 16, 1932 and thereafter the estate of Charles H. Robinson, petitioner herein, received the income from this property.

In each of the years 1932 to 1936, inclusive, the Estate of Charles H. Robinson received certain advance or minimum royalties. For each of these years the Estate of Charles H. Robinson claimed depletion deductions in its Federal income tax returns on account of said advance royalties. These depletion deductions were taken on the cost basis and were allowed by the respondent as proper deductions.

As of July 1, 1937, pursuant to the provisions of the lease, the Lessee cancelled and terminated the lease. No ore had been removed from the mine at any time during the existence of the lease.

In its Federal income tax return for 1937 the Estate of Charles H. Robinson reported no income by reason of the depletion deductions allowed to it for the years 1932 to 1936, inclusive.

Upon audit of petitioner's return for 1937 the respondent added to the gross income reported therein an amount equal to the aggregate of the deductions for depletion taken by it on each of its returns for the five years, 1932 through 1936, and based his determination of the deficiency upon this addition. The respondent made this addition pursuant to Article 23m—10(c) of Regulations 94. The Board sustained the action of the Commissioner in adding these amounts to petitioner's income for the year 1937.

Petitioner's position was and is that the inclusion of any of these amounts in the 1937 gross income constitutes an unlawful cumulation into one year of income received by it in a series of years.

III

Petitioners, being aggrieved by the conclusions of law contained in the opinion of the Board and by its decision [fol. 70] entered pursuant thereto, desire to obtain a review

thereof by the United States Circuit Court of Appeals for the Eighth Circuit.

IV

Assignments of Error

The petitioners assign as error the following acts of the Board of Tax Appeals:

1. The Board erred in holding as a conclusion of law that it was proper to include in petitioners' gross income for 1937 $379.13 of the depletion deduction taken and allowed for the year 1932.

2. The Board erred in holding as a conclusion of law that it was proper to include in peaitioners' gross income for the year 1937 an amount equal to the aggregate of the depletion deductions taken by petitioners and allowed by the respondent for each of the years 1932 to 1936, inclusive.

3. The Board erred in failing to hold as a conclusion of law that it was improper to include in the gross income for 1937 any amount based upon depletion deductions taken by petitioners and allowed by respondent for any of the years 1932 to 1936, inclusive.

Wherefore, Petitioners petition that the aforesaid decision of the Board be reviewed and that the errors of said decision be corrected by appropriate action of this Court.

James E. O'Brien & Kimball B. DeVoy, Counsel for Petitioners, 808 First National-Soo Line Bldg., Minneapolis, Minnesota.

Dated: July 29th, 1942.

Duly sworn to by James E. O'Brien and Kimball DeVoy. Jurats omitted in printing.

[fol. 71] IN UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted]

NOTICE OF FILING OF PETITION FOR REVIEW BY ESTATE OF CHARLES H. ROBINSON, ET AL., CO-EXECUTORS, IN CASE No. 102,869, AND ACKNOWLEDGMENT OF SERVICE—Filed August 3, 1942

[fol. 72] To: John P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Washington, D. C.

Please take notice that petitioners on the 3rd day of August, 1942, filed with the Clerk of the United States Board of Tax Appeals at Washington, D. C. a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit of the decision of the Board heretofore rendered in the above entitled cause, a copy of which petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 29th day of July, 1942, at Minneapolis, Minnesota.

Respectfully, James E. O'Brien & Kimball B. DeVoy, Counsel for Petitioners, 808 First National-Soo Line Bldg., Minneapolis, Minnesota.

Personal service of the foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 3rd day of August, 1942.

J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

IN UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted]

PETITION OF BERNICE B. DALRYMPLE IN CASE NO. 106,705 FOR REVIEW OF DECISION OF UNITED STATES BOARD OF TAX APPEALS—Filed August 3, 1942

To: The Honorable, The Judges of The United States Circuit Court of Appeals For The Eighth Circuit:

[fol. 73] Bernice B. Dalrymple, the petitioner in the above entitled matter, by James E. O'Brien and Kimball

B. DeVoy, her counsel, hereby files her petition for a review by the United States Circuit Court of Appeals for the Eighth Circuit of the decision by the United States Board of Tax Appeals rendered on May 9, 1940, 46 B. T. A. ....., No. 125, determining a deficiency in the petitioner's Federal income tax for the calendar year 1937, in the amount of $5,412.47, and respectfully shows:

I

Jurisdiction

The petitioner, Bernice B. Dalrymple, at the time of filing this petition is an individual, a citizen of the United States and a resident of Minneapolis, Minnesota, with her office at 953 Northwestern Bank Building, Minneapolis, Minnesota. Petitioner is the transferee of all of the assets of the Estate of Irene B. Robinson Cirkler, deceased. The Federal Income Tax return herein involved is the return for Irene B. Robinson Cirkler, deceased, an individual, covering the period from January 1, 1937 to October 20, 1937, the date of her death. The return involved was filed at the office of the Collector of Internal Revenue for the District of Minnesota, in St. Paul, Minnesota, which is located within the jurisdiction of the United States Circuit Court of Appeals for the Eighth Circuit. Subsequent to the decision of the Board, review of which is herein sought, petitioner paid in full the deficiency thereby determined, together with interest thereon as provided by law to the date of said payment.

II

Nature of Controversy

The controversy involves the propriety of cumulating income received by a cash-basis taxpayer in each of a series of eight years, adding the accumulated total to the gross income of the ninth year, and assessing the tax thereon at progressive rates for the ninth year.

The facts giving rise to this controversy are substantially as follows:

[fol. 74] Prior to 1929 Irene B. Robinson Cirkler, Bessie P. Douglas, Adeline R. Morse and Charles H. Robinson, were the owners of the Pettit iron mine in St. Louis County, Minnesota. Irene B. Robinson Cirkler, whose tax liability

is here in question, owned an undivided one-sixth interest in this property. In 1929 these owners leased the mine to the Republic Steel Company for a term of thirty (30) years commencing July 1, 1929.

In each of the years 1929 to 1936, inclusive, Irene B. Robinson Cirkler received certain advance or minimum royalties. For each of these years she claimed depletion deductions in her Federal income tax returns on account of said advance royalties. These depletion deductions were taken on the cost basis and were allowed by the respondent as proper deductions.

As of July 1, 1937, pursuant to the provisions of the lease, the Lessee cancelled and terminated the lease. No ore had been removed from the mine at any time during the existence of the lease.

In the Federal income tax return filed for Irene B. Robinson Cirkler for the period January 1, 1937, to October 20, 1937, no income was reported by reason of the depletion deductions allowed to her for the years 1929 to 1936, inclusive.

Upon audit of the return of the respondent added to the gross income reported therein an amount equal to the aggregate of the deductions for depletion taken by her on each of her returns for the eight years 1929 through 1936, and based his determination of the deficiency upon this addition. The respondent made this addition pursuant to Article 23m-10(c) of Regulations 94. The deficiency as thus determined was assessed against this petitioner as transferee of all of the assets of the Estate of Irene B. Robinson Cirkler, deceased. The Board sustained the action of the Commissioner in adding these amounts to Irene B. Robinson Cirkler's income for the period January 1, 1937 to October 20, 1937.

Petitioner's position was and is that the inclusion of any of these amounts in the 1937 gross income constitutes an unlawful cumulation into one year of income received by the taxpayer in a series of years.

[fol. 75] III

Petitioner, being aggrieved by the conclusions of law contained in the opinion of the Board and by its decision entered pursuant thereto, desires to obtain a review thereof

by the United States Circuit Court of Appeals for the Eighth Circuit.

IV

Assignments of Error

The petitioner assigns as error the following acts of the Board of Tax Appeals:

1. The Board erred in its conclusion of law that it was proper to include in the taxpayer's gross income for the period January 1, 1937 to October 20, 1937 an amount equal to the aggegate depletion deductions taken by petitioner and allowed by the respondent for each of the years 1929 to 1936, inclusive.

2. The Board erred by failing to hold as a conclusion of law that it was improper to include in the gross income for the period January 1, 1937 to October 20, 1937 any amount based upon depletion deductions taken by taxpayer and allowed by the respondent for any of the years 1929 to 1936, inclusive.

Wherefore, Petitioner petitions that the aforesaid decision of the Board be reviewed and that the errors of said decision be corrected by appropriate action of this Court.

James E. O'Brien, & Kimball B. DeVoy, Counsel for Petitioner, 808 First National-Soo Line Building, Minneapolis, Minnesota.

Dated: July 29th, 1942.

Duly sworn to by James E. O'Brien and Kimball B. DeVoy. Jurat omitted in printing.

[fol. 76] In United States Circuit Court of Appeals

[Title omitted]

Notice of Filing of Petition for Review by Bernice B. Dalrymple in Case No. 106705 and Acknowledgment of Service—Filed August 3, 1942

To: John P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Washington, D. C.

Please take notice that the petitioner on the 3rd day of August, 1942, filed with the Clerk of the United States

[fol. 77] Board of Tax Appeals at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit of the decision of the Board heretofore rendered in the above entitled cause, a copy of which petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 29th day of July, 1942, at Minneapolis, Minnesota.

James E. O'Brien, & Kimball B. DeVoy, Counsel for Petitioner, 808 First National-Soo Line Bldg., Minneapolis, Minnesota.

Personal service of the foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 3rd day of August, 1942.

J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

[Titles omitted]

ORDER FOR TRANSMISSION OF SINGLE CONSOLIDATED TRANSCRIPT OF RECORD AND AS TO CONSOLIDATION OF CASES FOR BRIEFING, HEARING, ARGUMENT AND DECISION, ETC.—Filed September 3, 1942.

B. T. A. Nos. 102869, 102870 and 106,705

[fol. 78] Now on consideration of the joint motion filed herein by counsel for the respective parties to the above-entitled proceedings, it is

Ordered, that the Clerk of the United States Board of Tax Appeals shall certify and transmit to this Court a single consolidated transcript of record on review in the above-entitled proceedings; that these proceedings be and they are hereby consolidated for briefing, hearing, argument and decision; that one brief shall be filed on behalf of the taxpayers and one on behalf of the Commissioner; and that the first brief shall be filed by the taxpayer who

shall print the consolidated record with such brief and shall bear 75 per centum of the cost of printing the record, leaving 25 per centum of such cost to be borne by the Commissioner.

It Is Further Ordered that the Clerk of this Court transmit to the Clerk of the United States Board of Tax Appeals a certified copy of this order to be by him incorporated in the record on review as certified and transmitted by him to this Court.

August 31, 1942.

A True Copy.

Attest:

E. E. Koch, Clerk, United States Circuit Court of Appeals, Eighth Circuit. (Seal.)

[fol. 79]. Before United States Board of Tax Appeals

* * * * * * *

Praecipe for Consolidated Record—Filed September 29, 1942

To The Clerk of The United States Board of Tax Appeals:

You are hereby requested by the parties to each of the above entitled causes to make a transcript of the consolidated record therein to be filed in the United States Circuit Court of Appeals for the Eighth Circuit, pursuant to review taken in each of said causes and to include in such transcript of record copies, duly certified as correct, of the following documents:

1. Docket entries of proceedings in each of said causes before the Board.

2. Pleadings in each of said causes before the Board as follows:

(1) Amended Petition of Bessie P. Douglas, filed July 27, 1940.

(2) Answer to Amended Petition of Bessie P. Douglas, filed August 29, 1940.

[fol. 80] (3) Amendment to Amended Petition of Bessie P. Douglas (embodied in petitioner's motion filed December 6, 1940, granted December 12, 1940).

(4) Answer to Amendment to Amended Petition of Bessie P. Douglas, filed January 22, 1941.

(5) Amended Petition of Estate of Charles H. Robinson, filed July 27, 1940.

(6) Answer to Amended Petition of Estate of Charles H. Robinson, filed August 29, 1940.

(7) Amendment to Amended Petition of Estate of Charles H. Robinson (embodied in petitioners' motion filed December 6, 1940, granted December 12, 1940).

(8) Answer to Amendment to Amended Petition of Estate of Charles H. Robinson, filed January 22, 1941.

(9) Petition of Bernice B. Dalrymple, filed March 20, 1941.

(10) Answer to Petition of Bernice B. Dalrymple, filed April 22, 1941.

(11) Reply to Answer to Petition of Bernice B. Dalrymple.

3. Stipulations of fact, as follows:

(1) Written stipulation of fact submitted at hearing before the Board, June 16, 1941.

(2) Oral Stipulation of fact submitted at hearing before the Board, June 16, 1941.

4. Opinion of the Board, promulgated April 14, 1942, including findings of fact therein.

5. Decisions of the Board entered May 9, 1942.

6. The Petitions for Review filed by taxpayers in each of said causes.

7. The Cross-petition for Review filed by The Commissioner in the case of Bessie P. Douglas.

8. Notice of filing petition for review and admission of service thereof in each of said causes.

[fol. 81] 9. This Praecipe.

The foregoing to be prepared, certified, and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Eighth Circuit.

James E. O'Brien & Kimball B. DeVoy, Counsel for Taxpayers. J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Counsel for Commissioner of Internal Revenue.

Dated: —— —, 1942.

Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 82] In United States Circuit Court of Appeals for the Eighth Circuit

* * * * * * *

Designation of Portions of Record to be Contained in Printed Record on Petitions for Review.—Filed October 28, 1942

To the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit:

The following portions of the consolidated record in the above-entitled causes are hereby designated as the portions of said record to be printed, as provided in order made by this Court on August 31, 1942, to-wit:

All of said record as certified by the Clerk of the Board of Tax Appeals and as filed herein except;

[fol. 83] 1. That portion of the written stipulation of fact submitted to the Board on June 16, 1941, which is referred to in paragraph A2 as Exhibit A, and which consists of a copy of lease and a copy of amendment thereto.

2. That portion of the aforesaid written stipulation of fact which relates to the case of Estate of Adeline R. Morse, John S. Dalrymple, Executor, contained in paragraph "C" of said stipulation and in subparagraphs 13, 14, 15, 16, 17, 18 and 19 under said paragraph "C".

3. That portion of amended petition of Bessie P. Douglas contained in subparagraphs 5(2), 5(3), 5(4), 5(9), 5(10), 5(11), and 5(12).

4. Amendment to amended petition of Bessie P. Douglas.

5. Answer to amendment to amended petition of Bessie P. Douglas.

6. That portion of amended petition of Estate of Charles H. Robinson contained in subparagraphs 5(3), 5(4), 5(9), 5(10), 5(11), and 5(12).

7. Amendment to amended petition of Estate of Charles H. Robinson.

8. Answer to amendment to amended petition of Estate of Charles H. Robinson.

9. That portion of amended petition of Bernice B. Dalrymple contained in subparagraphs 5(2), 5(3), 5(4), 5(9), 5(10), 5(11), 5(12) and 5(13).

James E. O'Brien & Kimball B. DeVoy, Counsel for Taxpayers. J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Counsel for Commissioner of Internal Revenue.

[File endorsement omitted.]

[fol. 84] (Appearances of counsel omitted in printing)

[fol. 85] IN UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT

No. 12461

BESSIE P. DOUGLAS, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

On Petition to Review Decision of United States Board of Tax Appeals

No. 12462

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

BESSIE P. DOUGLAS

On Petition to Review Decision of United States Board of Tax Appeals

No. 12463

ESTATE OF CHARLES H. ROBINSON, et al., Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE

On Petition to Review Decision of United States Board of Tax Appeals

and

No. 12464

BERNICE B. DALRYMPLE, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

On Petition to Review Decision of United States Board of Tax Appeals

ORDER OF SUBMISSION—March 2, 1943

These causes, Nos. 12461, 12462, 12463 and 12464, having been called for hearing in their regular order, the same are argued together by Mr. Kimball B. DeVoy for the taxpayers and by Miss Louise Foster, Special Assistant to Attorney General, for the Commissioner of Internal Revenue.

[fol. 86] Thereupon, these causes were submitted to the Court on the abstracts of records from said Board of Tax Appeals and the briefs of counsel filed herein.

[fol. 87] IN UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT

No. 12,461.—March Term, A. D. 1943

BESSIE P. DOUGLAS, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

On Petition to Review Decision of United States Board of Tax Appeals

No. 12,462.—March Term, A. D. 1943

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

BESSIE P. DOUGLAS, Respondent

On Petition to Review Decision of United States Board of Tax Appeals

No. 12,463.—March Term, A. D. 1943

ESTATE OF CHARLES H. ROBINSON, NORTHWESTERN NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, JESSIE P. ROBINSON and CHARLES J. ROBINSON, Co-executors, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

On Petition to Review Decision of United States Board of Tax Appeals

No. 12,464.—March Term, A. D. 1943

BERNICE B. DALRYMPLE, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

On Petition to Review Decision of United States Board of Tax Appeals

[fol. 88] Mr. Kimball B. DeVoy (Mr. James E. O'Brien was with him on the brief) for Taxpayers.

Miss Louise Foster, Special Assistant to the Attorney General (Mr. Samuel O. Clark, Jr., Assistant Attorney General, and Messrs. Sewall Key and A. F. Prescott, Special Assistants to the Attorney General, were with her on the brief) for Commissioner of Internal Revenue.

Before Gardner, Sanborn and Thomas, Circuit Judges.

OPINION—April 7, 1943

THOMAS, Circuit Judge, delivered the opinion of the court:

These appeals of three taxpayers from a decision (46 B. T. A. 943) of the United States Board of Tax Appeals, now the United States Tax Court, and a cross appeal of the Commissioner present two problems for determination: 1. Whether Article 23(m)-10(c) of Treasury Regulations 94 promulgated under the Revenue Act of 1936 is valid; and 2. If the regulation is valid, may the taxpayer in the taxable year exclude a depletion deduction taken in a former year when no tax benefit resulted from the deduction in the earlier year?

Both these problems have heretofore been determined by this court. In a similar case, *Lamont* v. *Commissioner*, 8 Cir., 120 F. 2d 996, the court held the regulation to be valid, and in *Harwick* v. *Commissioner*, 8 Cir., 133 F. 2d 732, the tax benefit theory was held to be invalid. Since the taxpayers contend that these cases are distinguishable from the Lamont case, supra, it will be necessary to examine the facts and the issues.

On July 1, 1929, four owners of an iron mine in Minnesota leased it to an operating company for a term of 30 years. The lease provided for the payment of minimum [fol. 89] royalties annually whether ore was extracted or not. Royalties paid in advance of extraction were to be applied on ore mined later. The lessee was given the right to cancel the lease; and this right was exercised and the lease terminated July 1, 1937, without any ore having been removed from the mine during the existence of the lease.

While the lease was in force the agreed royalties were paid to the lessors or their successors and returned by them as gross income in the years received. In the same years deductions for depletion were taken and allowed. For 1937, the year in which the lease was terminated, the Commissioner, pursuant to the provisions of paragraph (c) of

Article 23(m)-10 of Regulations 94, promulgated under the Revenue Act of 1936, included in the gross income of the several taxpayers sums corresponding to the aggregate amounts of the deductions taken by each of them, or of their transferors, during the years the lease was in force from 1929 to 1937.

The case of the taxpayer Douglas differs from the others in that, although she took and was allowed a depletion deduction for the year 1933 in the amount of $4,958.05, her net loss for that year before taking the deduction was $8,989.46. This situation gives rise to the second question presented for decision.

Upon appeal to the Board of Tax Appeals the Commissioner's action in including in taxable income for 1937 amounts equivalent to the depletion deductions taken and allowed in prior years was sustained in all of the cases involved except as to the $4,958.05 in the Douglas case. In respect of this item the Commissioner was reversed on the ground that the deduction in 1933 did not offset a taxable income, that is, that the taxpayer received no tax benefit from the deduction.

[fol. 90] The contention of all the taxpayers in this court is that the Board erred in sustaining the action of the Commissioner in including sums corresponding to the aggregate depletion deductions of prior years in taxable income of 1937. The taxpayers insist that the regulation, which with the statute is copied in the margin,[1] is invalid

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[1] Section 23 of the Revenue Act of 1936, c. 690, 49 Stat. 1648, provides:

In computing net income there shall be allowed as deductions:

* * * * * * *

(m) *Depletion.*—In the case of mines, * * * a reasonable allowance for depletion * * *; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

because (1) unreasonable and (2) in conflict with the statute.

The taxpayers' charge of invalidity is directed against the last phrase of paragraph (c) of Article 23(m)-10 of Regulations 94. This paragraph provides that if depletion deductions are allowed for advance royalties and no production occurs during the life of the lease, "the lessor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and a cor- [fol. 91] responding amount must be returned as income *for the year in which the lease expires, terminates, or is abandoned.*" (Italics supplied.)

The taxpayers' only "essential quarrel" is with the phrase printed in italics, although the validity of all of paragraph (c) is questioned. The objection to the regulation is based upon the claim (1) that it requires income received in one year to be included in the income of a later year in which it was not received; (2) that it cumulates income received in each of a series of years and taxes it as if received in one year; and (3) that the regulation thus imposes a penalty upon the taxpayer, is harsh and unrea-

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Art. 23(m)-10. *Depletion—Adjustments of accounts* based on bonus or advanced royalty.—* * *

(b) If the owner has leased a mineral property for a term of years with a requirement in the lease that the lessee shall * * * pay, annually, a specified sum of money which shall be applied in payment of the * * * royalty per unit of such mineral whenever the same shall thereafter be extracted and removed from the leased premises, an amount equal to that part of the basis for depletion allocable to the number of units so paid for in advance of extraction will constitute an allowable deduction from the gross income of the year in which such payment or payments shall be made.

(c) If for any reason any such mineral lease expires or terminates or is abandoned before the mineral which has been paid for in advance has been extracted and removed, the lessor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned.

sonable, lacks common sense justification, is vicious in its results, is not equitable, and violates the statute.

Section 23(m) of the Revenue Act of 1936, supra, has been in the law continuously in substantially similar form beginning with the Revenue Act of 1918; and Article 23(m)-10(c) of Regulations 94 had its beginning in Regulations 45 under the Act of 1918 and has existed in the regulations ever since. It was approved in effect by the Supreme Court in *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299. But in *Herring* v. *Commissioner*, 293 U. S. 322, 328, decided after the Murphy Oil Co. case, the court said, "As to income tax liability in the year of termination of the lease, on account of bonus paid at the execution of the lease, if no mineral has been extracted, we express no opinion." Because of this expression of the Supreme Court, the taxpayers contend that the validity of the regulation is an open question. Congress, however, has shown its approval of the regulation by the repeated reenactment of the statute without any change in the regulation. *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301, 307-8. Its validity has been sustained by this court in *Lamont* v. *Commissioner, supra;* and by the [fol. 92] 5th Circuit Court of Appeals in *Sneed* v. *Commissioner*, 119 F. 2d 767, and *Crabb* v. *Commissioner*, 119 F. 2d 772.

The contention that the regulation requires income in one year to be included in the income of a later year in which it was not received, thus cumulating income for a series of years, is erroneous. Depletion deductions are allowed on the theory that depletion represents the costs of a wasting capital asset. *United States* v. *Ludley*, 274 U .S. 295, 302. When claimed and allowed depletion is treated and regarded as a reduction, or loss, of capital. When a mining lease is terminated without production the amounts allowed as deductions for such assumed capital losses resulting from advance payments in prior years may for the first time be regarded as income. Until then the depletion deduction is carried on the books of the taxpayer as a capital loss; and, as between the taxpayer and the Commissioner, it retains that status until it is determined upon expiration of the lease that the mineral paid for in advance was not removed from the mine. The status of the depletion deduction then, and not until then, changes from capital loss to income both on the books of the lessor-taxpayer and for

tax purposes. This is the condition upon which the deduction is allowed. In the present case the same regulation being in effect during each year the lease was in effect, and in which year the deduction was claimed and allowed, the rule applies to the allowance in each year severally. While the total amount returned as income in 1937 corresponded to the aggregate amount of the deductions in prior years, it was not the deductions which were returned as income. It was only an equal amount. None of the several amounts returned was regarded as income in the prior years. They could not be so regarded prior to 1937.

Depletion allowed as a deduction in such a case is analogous to a deduction properly taken for a reserve for [fol. 93] some specific purpose where it is afterwards discovered that more was reserved and deducted than necessary in one year, and the excess having been restored to the original account on the books of the taxpayer was released for general use in a later year. The amount so released must be added to income in the year when made available as income. See *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, 352. A regulation requiring such procedure is neither unreasonable nor violative of any statute. The fact that in particular cases the application of the regulation may cumulate amounts corresponding to depletion deductions allowed in several previous years does not affect the logic nor the validity of the procedure. The same rule applies to deductions for depreciation. Further illustrations of the application of the principle of the regulation are given in the opinion of the court in *Sneed* v. *Commissioner*, *supra*, at page 771.

The complaint that the regulation is harsh and imposes a penalty upon the taxpayer was presented to the Board and overruled. The Board observed that the hardship complained of does not result entirely from the regulation but results in part from the fact that the income tax rates were increased over the period 1929 to 1937, and the depletion deductions were taken in years in which the incomes of the taxpayers were at comparatively low levels. Had the situation been reversed, a saving in taxes instead of a loss might have resulted from cumulating the amounts of the prior deductions in 1937. There would have been a saving had the tax rate been substantially lower in 1937 than in the former years and the incomes of the taxpayers

substantially greater in those years than in 1937. A tax law is not required to operate uniformly upon all taxpayers and according to the peculiar and fortuitous circumstances of each one. Geographic, not intrinsic, uni-[fol. 94] formity is all that is required. *Bromley* v. *McCaughn*, 280 U. S. 124; *Brushaber* v. *Union Pacific R. Co.*, 240 U. S. 1.

We hold that the regulation complained of is valid, and that the Board correctly so found.

The Commissioner contends that the Board erred in excluding from taxation in 1937 the sum of $4,958.05 deducted by Mrs. Douglas as depletion in 1933 on the ground that she had sustained a net loss in that year and for that reason had received no tax benefit on account of the deduction.

The principle upon which the tax benefit theory rests is that where the depletion deduction claimed and allowed in the prior year did not effect an offset of taxable income in that year, the amount released by restoring to the capital account the cost of the ore paid for but not removed in a later year does not constitute taxable income for the year in which it was released. If valid, the principle is applicable to the recovery of capital in any taxable year, the loss of which was charged off and for which a deduction was claimed and allowed in a prior year.

Since the Board's decision was rendered in the case of Mrs. Douglas this court has rejected the tax benefit theory in *Harwick* v. *Commissioner*, 8 Cir., 133 F. 2d. 732. It has also been rejected by the 4th Circuit Court of Appeals in *Helvering* v. *State-Planters Bank & Trust Co.*, 130 F. 2d 44, and in *Helvering* v. *Virginian Hotel Corporation*, 132 F. 2d 909.

The grounds upon which this court rejects the principle applied by the Board are: (1) That it is not in accordance with law, making it our duty to reverse under the statute. 26 U. S. C. § 1141(c) (1), Supp. 1939. The principle under consideration is not found in the statute nor any of the [fol. 95] regulations, and it injects into the law of deductions an equitable consideration contrary to the strict construction required to be placed upon statutes allowing deductions. *Deputy* v. *du Pont*, 308 U. S. 488, 493; *Harwick* v. *Commissioner, supra.* (2) The taxpayer is given an option to take or not to take a deduction for depletion. If he takes

and is allowed a deduction he takes it subject to the conditions prescribed by the law in effect in the year of allowance. In the instant case Article 23(m)-10(c), of Regulations 94 was in effect in 1933 when Mrs. Douglas took and was allowed the deduction involved in this controversy. Since the regulation was valid, it had the force and effect of law. *Maryland Casualty Co.* v. *United States, supra,* at page 349. The allowance of the deduction was therefore subject to the condition prescribed by the regulation, that is, that in the event no ore was mined during the continuance of the lease an amount corresponding to the amount of the deduction would be included in income in the year of the termination of the lease. The regulation involved does not exempt such income from deductions for losses occurring in the taxable year. It is consistent with the rule that under the federal system of taxation income must be computed annually as the net result of all transactions within the year. *Burnet* v. *Sanford & Brooks Co.,* 282 U. S. 359, 365.

For the foregoing reasons the cases are all affirmed on the petitions of the taxpayers, and No. 12,462, Commissioner v. Douglas, is reversed on the petition of the Commissioner.

[fol. 96] IN UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT

No. 12461

BESSIE P. DOUGLAS, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

On Petition to Review Decision of United States Board of Tax Appeals

and

No. 12462

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

BESSIE P. DOUGLAS

On Petition to Review Decision of United States Board of Tax Appeals

JUDGMENT—April 7, 1943

These causes came on to be heard on the petitions filed by the Taxpayer and the Commissioner of Internal Revenue to review the decision of the United States Board of Tax Appeals, entered May 9, 1942, and were argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the decision of the said Board of Tax Appeals in these causes upon the petition of the Taxpayer be, and it is hereby, affirmed, and that on the petition of the Commissioner the said decision be, and the same is hereby, reversed.

And it is further Ordered by this Court that no costs be taxed in favor of either of the parties in this Court, and that these causes be and they are hereby remanded to The Tax Court of the United States as the Successor to the United States Board of Tax Appeals.

[fol. 97] IN UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT

No. 12463

ESTATE OF CHARLES H. ROBINSON, NORTHWESTERN NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, JESSIE P. ROBINSON and CHARLES J. ROBINSON, Co-Executors, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

On Petition to Review Decision of United States Board of Tax Appeals

JUDGMENT—April 7, 1943

This cause came on to be heard on the petition to review the decision of the United States Board of Tax Appeals entered May 9, 1942, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the decision of the said Board of Tax Appeals in this cause be, and the same is hereby, affirmed.

And it is further Ordered by this Court that the petition to review herein be, and it is hereby, dismissed without taxation of costs in favor of either of the parties in this Court.

[fol. 98] IN UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT

No. 12464

BERNICE B. DALRYMPLE, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

On Petition to Review Decision of United States Board of Tax Appeals

JUDGMENT—April 7, 1943

This cause came on to be heard on the petition to review the decision of the United States Board of Tax Appeals entered May 9, 1942, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the decision of the said Board of Tax Appeals in this cause be, and the same is hereby, affirmed.

And it is further Ordered by this Court that the petition to review herein be, and it is hereby, dismissed without taxation of costs in favor of either of the parties in this Court.

[fols. 99-100] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 101] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1943

No. 130

[Title omitted]

ORDER ALLOWING CERTIORARI—Filed January 10, 1944

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 102] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1943

No. 131

[Title omitted]

ORDER ALLOWING CERTIORARI—Filed January 10, 1944

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 103] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1943

No. 132

ORDER ALLOWING CERTIORARI—Filed January 10, 1944

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 104] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1943

No. 133

ORDER ALLOWING CERTIORARI—Filed January 10, 1944

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on Cover: Enter Thomas P. Helmey. File Nos. 47623, 47624, 47625, 47626. U. S. Circuit Court of Appeals, Eighth Circuit. Term No. 130. Bessie P. Douglas, Petitioner, vs. Commissioner of Internal Revenue. Term No. 131. Bessie P. Douglas, Petitioner, vs. Commissioner of Internal Revenue. Term No. 132. Estate of Charles H. Robinson, Northwestern National Bank and Trust Company of Minneapolis, Jessie P. Robinson, et al., etc., Petitioners, vs. Commissioner of Internal Revenue. Term No. 133. Bernice B. Dalrymple, Petitioner, vs. Commissioner of Internal Revenue. Petition for writs of certiorari and exhibit thereto. Filed July 1, 1943. Term Nos. 130 O. T. 1943, 131 O. T. 1943, 132 O. T. 1943, 133 O. T. 1943.

FILE COPY

IN THE

Supreme Court of the United States

No. 130

BESSIE P. DOUGLAS, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

(C. C. A., Docket No. 12,461.)

No. 131

BESSIE P. DOUGLAS, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

(C. C. A., Docket No. 12,462.)

No. 132

ESTATE OF CHARLES H. ROBINSON, NORTHWESTERN NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, JESSIE P. ROBINSON and CHARLES J. ROBINSON, Co-Executors,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

(C. C. A., Docket No. 42,463.)

No. 133

BERNICE B. DALRYMPLE, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

(C. C. A., Docket No. 12,464.)

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

JAMES E. O'BRIEN and
KIMBALL B. DeVOY,
Attorneys for Petitioners,
808 First National-Soo Line Building,
Minneapolis, Minnesota.

Of Counsel:
THOMAS P. HELMEY,
1100 First National-Soo Line Building,
Minneapolis, Minnesota.

INDEX.

	Page
Petition	1
Statement of Matters Involved	3
Provisions of Statutes and Regulations Involved	4
Statement of Facts	6
Questions Presented	8
Reasons for Allowance of Writs of Certiorari	8
Brief in Support of Petition for Writs of Certiorari	10
Opinions Below	10
Jurisdiction	10
Summary of Argument	10
Argument	11
1. The Circuit Court of Appeals, in deciding that amounts equal to depletion deductions taken from 1929 to 1936 constitute taxable income for 1937, has decided that it is proper for the Commissioner of Internal Revenue, by regulation, to cumulate items of receipt received in separate annual amounts in each of a series of years and to include the aggregate in taxable income of a subsequent year, and thus it has decided a question of Federal income tax law in a way which is in conflict with applicable decisions of this court	11
2. The Circuit Court of Appeals, in deciding that amounts equal to depletion taken from 1929 to 1936 constitute taxable income for 1937, has decided that it is proper for the Commissioner of Internal Revenue, by regulation, to adjust taxpayer's basis upwards by the amount of past depletion and to require the inclusion of a corresponding amount in the gross income of the year of lease termination, and thus it has decided an important question of Federal income tax law which has not been, but should be, settled by this court	13
3. The Circuit Court of Appeals, in deciding that amounts equal to depletion deductions of prior years must be included in gross income in the year of cancellation of lease in spite of the fact that the deductions did not offset income or reduce income tax, has decided an important question of Federal income tax law which has not been, but should be, settled by this court	17
Conclusion	18

CASES CITED.

Page

Burnet vs. Sanford & Brooks Co. (1931), 282 U. S. 359, 51 Sup. Ct. 150, 75 L. Ed. 383 ..... 12, 13

Crabb vs. Commissioner, 5th Circuit, 119 F. (2d) 772 16

Harwick vs. Commissioner (1943), 133 F. (2d) 732 ..... 13, 17, 18

Helvering vs. American Dental Co., ... U. S. ..., 87 L. Ed. 574, 63 S. Ct. 577 (Mar. 1, 1943) 13

Helvering vs. Morgan's, Inc. (1934), 293 U. S. 121, 79 L. Ed. 232, 55 S. Ct. 60 13

Herring vs. Commissioner (1935), 293 U. S. 322, 79 L. Ed. 389, 55 S. Ct. 179 ..... 14, 15, 16

Lamont vs. Commissioner, 8th Circuit, 120 F. (2d) 996 ..... 16, 17, 18

Murphy Oil Co. vs. Burnet (1932), 287 U. S. 299, 77 L. Ed. 318, 53 S. Ct. 161 ..... 14, 15, 16

Sneed vs. Commissioner, 5th Circuit, 119 F. (2d) 767 16

Snyder vs. Commissioner (1935), 295 U. S. 134, 79 L. Ed. 1351, 55 S. Ct. 737 13

Virginian Hotel Co. vs. Commissioner, ... U. S. ..., decided June 7, 1943 ..... 15, 18

STATUTES CITED.

Section 23(m), Revenue Act of 1936 ..... 4, 13, 15

Section 41, Revenue Act of 1936 ..... 4, 13

Section 42, Revenue Act of 1936 ..... 4, 12

Section 113(b)(1)(B), Revenue Act of 1936 ..... 5, 14, 15, 18

Section 240 of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938 10

Article 23(m)-10(c) of Regulations 94 ..... 5, 7, 13, 16, 18

IN THE

Supreme Court of the United States

No. .....

BESSIE P. DOUGLAS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

(C. C. A., Docket No. 12,461.)

No. .....

BESSIE P. DOUGLAS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

(C. C. A., Docket No. 12,462.)

No. .....

ESTATE OF CHARLES H. ROBINSON, NORTHWESTERN NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, JESSIE P. ROBINSON AND CHARLES J. ROBINSON, CO-EXECUTORS,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

(C. C. A., Docket No. 12,463.)

No. .....

BERNICE B. DALRYMPLE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

(C. C. A., Docket No. 12,464.)

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

To the Honorable Harlan F. Stone, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

Bessie P. Douglas, Bernice B. Dalrymple, and Northwestern National Bank and Trust Company of Minneapolis, Jessie P. Robinson and Charles J. Robinson, as Co-executors of the Estate of Charles H. Robinson, deceased, respectfully pray for writs of certiorari to review the judgments of the Circuit Court of Appeals for the Eighth Circuit entered on April 7, 1943 (R. 94-96).

These judgments affirmed the decision of the United States Board of Tax Appeals (now the United States Tax Court) in the cases of Bessie P. Douglas vs. Commissioner of Internal Revenue, No. 12,461, and Estate of Charles H. Robinson, Northwestern National Bank and Trust Company of Minneapolis, Jessie P. Robinson and Charles J. Robinson, Co-executors, vs. Commissioner of Internal Revenue, No. 12,463, and Bernice B. Dalrymple vs. Commissioner of Internal Revenue, No. 12,464, and reversed the

decision of the United States Board of Tax Appeals in the case of Commissioner of Internal Revenue vs. Bessie P. Douglas, No. 12,462.

STATEMENT OF MATTERS INVOLVED

These cases involve the legality, under the Revenue Act of 1936 and corresponding provisions of later Revenue Acts and of the Internal Revenue Code, of treating as taxable income in the year 1937, amounts deducted as depletion against advance royalties over a series of years prior to 1937, in a case in which a mining lease was terminated in 1937 without extraction of ore during the term of the lease.

The taxpayers were the owners of fee interests in a tract of iron ore mining property. As lessors of that property, they received advance royalties under a mining lease in each of the years 1929 to 1936, inclusive. As provided by law, they claimed and were allowed deductions for depletion in each of said years. In 1937 the lease was cancelled by the mining company and no ore had been mined during the life of the lease. The aggregate of depletion deductions taken and allowed during the eight years prior to 1937 was subjected to taxation as gross income in the year 1937. Even deductions, which resulted in no tax saving when taken, were treated as income in the year of termination. The result of this treatment was a gross overstatement and distortion of the taxpayers' net income for the year 1937.

PROVISIONS OF STATUTES AND REGULATIONS INVOLVED

Section 41, Revenue Act of 1936:

"SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year."

Section 42, Revenue Act of 1936:

"SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *"

Section 23(m), Revenue Act of 1936:

"SEC. 23. DEDUCTIONS FROM GROSS INCOME.

(In computing net income there shall be allowed as deductions:)

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commis-

sioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. * * *"

Section 113(b)(1)(B), Revenue Act of 1936:

"SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(b) *Adjusted basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) GENERAL RULE.—Proper adjustment in respect of the property shall in all cases be made—

(A) * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. * * *"

Article 23(m)-10(c), Regulations 94:

"If for any reason any such mineral lease expires or terminates or is abandoned before the mineral which has been paid for in advance has been extracted and removed, the lessor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned."

STATEMENT OF FACTS

The stipulated facts (R. 39-47) in each of the above cases, which were consolidated for briefing, argument and decision in the Circuit Court of Appeals and for the preparation of this petition, were adopted by the United States Board of Tax Appeals as its findings of fact (R. 49). With respect to the first issue presented by these cases, no material distinction exists in the facts and in the interests of clarity we shall set forth only the facts of the case of Bessie P. Douglas vs. Commissioner of Internal Revenue.

In the year 1929 Bessie P. Douglas, the owner of an undivided one-half interest in a certain iron ore mining property, together with owners of the remaining interests, leased the property to an iron mining company. In each of the years 1929 to 1936, inclusive, she received certain advance royalty payments required under the lease to be paid whether ore was mined or not but to be applicable upon ore later mined during the life of the lease. In filing her returns upon the cash basis in each of those years, she reported all of the royalties received by her and deducted amounts for depletion. These deductions were proper under the law and were allowed by the Commissioner. By making the deductions Bessie P. Douglas reduced her total income tax liability for the eight years 1929 to 1936, inclusive, by an aggregate of $6,923.51. In 1937 the lease was cancelled and no ore had been mined. The Commissioner added to the income reported by the taxpayer on her return for 1937, the sum of $53,299.03, which was the total of the royalty which went untaxed during the previous eight years. As a result her alleged net income was more than doubled and the tax imposed by reason of the inclusion in gross income of the aggregate of past depletion deductions was $26,550.65. In this way the Commissioner recovered all of the tax saved by

petitioner in the previous eight years, plus approximately $20,000.00. The Commissioner asserted the tax under the provisions of Article 23(m)-10(c) of Regulations 94, which provides as follows:

> "If for any reason any such mineral lease expires or terminates or is abandoned before the mineral which has been paid for in advance has been extracted and removed, the lessor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned."

The petitioner asserted that the regulation was invalid on the grounds that it was in conflict with pertinent provisions of the Revenue Act.

The second issue raised by these cases involves the taxability in 1937 of amounts deducted for depletion where no reduction in tax was effected by the deductions.[1] For example, the deduction by Bessie P. Douglas of $4,958.05 in 1933 resulted in no tax benefit to the taxpayer yet the Commissioner required its inclusion in gross income of 1937.

The Board of Tax Appeals held that the regulation was valid as applied to deductions of previous years which had offset taxable income but invalid as applied to the deduction of 1933, which resulted in no tax benefit (R. 57). The three taxpayers appealed from the decision holding the regulation valid and the Commissioner cross-appealed from that portion of the decision, holding the regulation invalid as applied to depletion deductions resulting in no tax benefit in the earlier years. The cases were consolidated before the Circuit Court of Appeals for the Eighth Circuit and on April

[1] This relates to the 1933 and 1934 deductions of Bessie P. Douglas and the 1932 deduction of Estate of Charles H. Robinson. The entire 1933 deduction was of no tax benefit and portions of the 1932 and 1934 deductions were of no tax benefit.

7, 1943, that court entered the following decision (R. 94):

As to the appeals taken by the taxpayers, the court affirmed the decision of the Board holding that an amount equal to the prior depletion deductions constituted income in 1937.

As to the appeal taken by the Commissioner, the court reversed the decision of the Board asserting that the fact that the depletion deducted in prior years effected no reduction in taxable income did not affect the validity of the regulation.

QUESTIONS PRESENTED

The issues raised by this litigation are as follows:

(1) Can the Commissioner of Internal Revenue lawfully require the lessor of a mining property to include in the gross income of the year in which a mining lease terminates the aggregate sum of amounts deducted for depletion in prior years against advance royalty payments, where no ore has been mined?

(2) If so, can this requirement be applied in the case of past depletion deductions which did not offset taxable income when deducted?

REASONS FOR ALLOWANCE OF WRITS OF CERTIORARI

1. The Circuit Court of Appeals, in deciding that amounts equal to depletion deductions taken from 1929 to 1936 constitute taxable income for 1937, has decided that it is proper for the Commissioner of Internal Revenue, by regulation, to cumulate items of receipt received in separate annual amounts in each of a series of years and to include the aggregate in taxable income of a subsequent year, and thus it

has decided a question of Federal income tax law in a way which is in conflict with applicable decisions of this court.

2. The Circuit Court of Appeals, in deciding that amounts equal to depletion taken from 1929 to 1936 constitute taxable income for 1937, has decided that it is proper for the Commissioner of Internal Revenue, by regulation, to adjust taxpayer's basis upwards by the amount of past depletion and to require the inclusion of a corresponding amount in the gross income of the year of lease termination, and thus it has decided an important question of Federal income tax law which has not been, but should be, settled by this court.

3. The Circuit Court of Appeals, in deciding that amounts equal to depletion deductions of prior years must be included in gross income in the year of cancellation of lease in spite of the fact that the deductions did not offset income or reduce income tax, has decided an important question of Federal income tax law which has not been, but should be, settled by this court.

WHEREFORE, your petitioners respectfully pray that writs of certiorari issue to the United States Circuit Court of Appeals for the Eighth Circuit in each of the above entitled cases, and submit their brief hereto attached in support of this petition.

Respectfully submitted,

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Dated: June 25th, 1943.

BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI

OPINIONS BELOW

The Opinion of the Circuit Court of Appeals for the Eighth Circuit rendered April 7, 1943—134 Fed. (2d) 762, is found at R. 85. The opinion of the United States Board of Tax Appeals (46 B. T. A. 943) is found at R. 47.

JURISDICTION

This petition is made under Section 240 of the Judicial Code as amended by the Act of February 13, 1925, 43 Stat. 938. The date of the judgments for which review is requested is April 7, 1943.

SUMMARY OF ARGUMENT

1. The Circuit Court of Appeals, in deciding that amounts equal to depletion deductions taken from 1929 to 1936 constitute taxable income for 1937, has decided that it is proper for the Commissioner of Internal Revenue, by regulation, to cumulate items of receipt received in separate annual amounts in each of a series of years and to include the aggregate in taxable income of a subsequent year, and thus it has decided a question of Federal income tax law in a way which is in conflict with applicable decisions of this court.

2. The Circuit Court of Appeals, in deciding that amounts equal to depletion taken from 1929 to 1936 constitute taxable income for 1937, has decided that it is proper for the Commissioner of Internal Revenue, by regulation, to adjust taxpayer's basis upwards by the amount of past depletion and to require the inclusion of a corresponding amount in

the gross income of the year of lease termination, and thus it has decided an important question of Federal income tax law which has not been, but should be, settled by this court.

3. The Circuit Court of Appeals, in deciding that amounts equal to depletion deductions of prior years must be included in gross income in the year of cancellation of lease in spite of the fact that the deductions did not offset income or reduce income tax, has decided an important question of Federal income tax law which has not been, but should be, settled by this court.

ARGUMENT

1. The Circuit Court of Appeals, in Deciding That Amounts Equal to Depletion Deductions Taken from 1929 to 1936 Constitute Taxable Income for 1937, Has Decided That It Is Proper for the Commissioner of Internal Revenue, by Regulation, to Cumulate Items of Receipt Received in Separate Annual Amounts in Each of a Series of Years and to Include the Aggregate in Taxable Income of a Subsequent Year, and Thus It Has Decided a Question of Federal Income Tax Law in a Way Which Is in Conflict With Applicable Decisions of This Court.

Separate annual deductions were taken by taxpayers from 1929 to 1936. By reason thereof separate annual portions of royalty received went free of tax because they constituted an apparent return of capital. An aggregate of $53,299.03 in depletion deductions was taken by Bessie P. Douglas over eight taxable years. An aggregate of $53,299.03 royalty *received by her in separate annual amounts over eight taxable years* went free of tax. In effect, the Circuit Court held that the $53,299.03 untaxed royalty of eight consecutive years constituted gross income of the ninth year in

which *none of it was received.* There can be no clearer case of cumulation of the income of many years.

This court held in *Burnet vs. Sanford & Brooks Co.* (1931), 282 U. S. 359, 51 Sup. Ct. 150, 75 L. Ed. 383, that an item of gross income received in a later year could not be drawn back to the year when related deductions were incurred. In effect, this court held that, where there is no accrual, *the time for inclusion in income is the year in which the item is received.* And that principle is clearly enunciated in Section 42 of the Revenue Act of 1936, which provides as follows:

> "The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, * * *."

The Circuit Court of Appeals decided that the items were received *prior to 1937*, but that because of the termination of the lease in 1937 their "status" as capital when received "then, and not until then, changes from capital loss to income both on the books of the lessor-taxpayer and for tax purposes" (R. 91).

Even were we to concede that there exists some process by which the "status" of an item can change from capital to income such a theoretical metamorphosis cannot change the fundamental and actual facts as to the time when the item was received. This court in the *Sanford & Brooks Co.* case, *supra*, has held that the *year of receipt* is the controlling factor and not the year in which an alleged change in "status" occurs.

By violating the fundamental rule as to time of receipt, by bunching items received in each of a series of years, the Circuit Court departed grossly from the principle laid down in *Burnet vs. Sanford & Brooks Co., supra*, that income taxes are to be determined on the basis of the taxpayer's

annual accounting period and on the basis of the net result of all transactions *within the year*. By permitting the cumulation of eight years' receipts the Circuit Court has sanctioned the imposition of surtax rates, designed only for annual incomes, against an unlawfully distorted net income containing the aggregate of incomes of many years.

The rule of *Burnet vs. Sanford & Brooks Co., supra*, has been applied or approved in subsequent decisions of this court and in numerous decisions of the courts below.

Helvering vs. American Dental Co., ... U. S. ..., 87 L. Ed. 574, 63 S. Ct. 577 (Mar. 1, 1943).

Snyder vs. Commissioner (1935), 295 U. S. 134, 79 L. Ed. 1351, 55 S. Ct. 737.

Helvering vs. Morgan's, Inc. (1934), 293 U. S. 121, 79 L. Ed. 232, 55 S. Ct. 60.

Harwick vs. Commissioner (1943), 133 Fed. (2d) 732.

See also Section 41, Revenue Act of 1936.

2. The Circuit Court of Appeals, in Deciding That Amounts Equal to Depletion Taken from 1929 to 1936 Constitute Taxable Income for 1937, Has Decided That It Is Proper for the Commissioner of Internal Revenue, by Regulation, to Adjust Taxpayer's Basis Upwards by the Amount of Past Depletion and to Require the Inclusion of a Corresponding Amount in the Gross Income of the Year of Lease Termination, and Thus It Has Decided an Important Question of Federal Income Tax Law Which Has Not Been, But Should Be, Settled by This Court.

The statutory authority for Article 23(m)-10(c) rests, if at all, only in Section 23(m) of the Revenue Act, the material portions of which provide as follows:

"In computing net income there shall be allowed as deductions:

* * * *

(m) *Depletion.*—in the case of mines, ... , a reasonable allowance for depletion . . . ., according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the secretary."

This court has held that this statute *requires* the Commissioner to permit the deduction of depletion from advance payments received prior to extraction.

Herring vs. Commissioner (1935), 293 U. S. 322, 79 L. Ed. 389, 55 S. Ct. 179.

This court has held that the taxpayer must take his deduction for depletion, if ever, in the year in which the advance payment is received and that he cannot wait until production commences.

Murphy Oil Co. vs. Burnet (1932), 287 U. S. 299, 77 L. Ed. 318, 53 S. Ct. 161.

Herring vs. Commissioner (1935), 293 U. S. 322, 79 L. Ed. 389, 55 S. Ct. 179.

The Revenue Act provides that even if the taxpayer refrains from deducting depletion his basis is reduced annually by the amount of depletion *allowable.*

Section 113(b)(1)(B), Revenue Act of 1936:

"(b) *Adjusted basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of the property whenever acquired shall be the basis determined under subsection (a), adjusted as hereinafter provided.

"(1) GENERAL RULE.—Proper adjustment in respect to the property shall in all cases be made—

"(A) * * * * * *

"(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization and depletion, to the extent allowed (but

not less than the amount allowable) under this Act or prior income tax laws. * * * *"

The Revenue Act further provides that the basis for depletion shall remain fixed as reduced *even though it is found that prior depletion was excessive.*

"In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate *(but not the basis for depletion)* shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate." (Italics added.)

Section 23(m), Revenue Act of 1936.

In the face of this provision of the Revenue Act, the Commissioner assumes the authority to raise the basis upon termination of a lease and by a bookkeeping "credit" to assign a corresponding amount to the income of that year.

In view of the decisions of this court in the *Murphy Oil Company* case, *supra*, and in the *Herring* case, *supra*, the taxpayer is forced by regulation into the inextricable dilemma of (1) refraining completely from his granted right of deducting depletion, yet watching his basis reduced annually by the operation of Section 113(b)-1(B) or (2) subjecting himself to this floating and ever growing potential tax liability by exercising his lawful privilege.

Raising the basis by the amount of past depletion deemed excessive is, of course, the opposite of what must be done where there is excessive past depreciation. In such a case the basis remains reduced, and depreciation for the future is computed upon such reduced base.

Virginian Hotel Corporation vs. Commissioner, ... U. S. ..., decided June 7, 1943.

And the same procedure is prescribed for excessive past depletion by the above quoted portion of Section 23(m) for

a case in which, as the result of "operations or of development work," the depletion is discovered to have been excessive. Congress went to considerable pains to provide that the basis be not revised in this case. Yet the Commissioner feels free to raise the basis in a case identical in principle though not in detail.

Although a reference was made to Article 23(m)-10(c) of Regulations 94 by this court in the *Murphy Oil Co.* case, *supra* (wherein the point was not in issue), the question was specifically left open by the closing sentence of the opinion of this Court in the *Herring* case, *supra:*

> "As to income tax liability in the year of termination on account of bonus paid at the execution of the lease, if no mineral has then been extracted, we express no opinion."

We believe and we urge upon this court that the issue is an important one not only for lessees of oil, gas, mineral and other depletable properties whose leases have been terminated but it is a highly important one to have resolved for the guidance of those who are now deducting or are entitled to deduct depletion against advance payments. To condition by regulation the allowance of a deduction given by Congress in such a way as to make it more desirable to forego recovery of capital than to take the deduction, is in effect to tax the recovery of capital and to deny to the taxpayer the reasonable allowance provided by statute. The issue raised is one which should be put at rest by this court.

This issue has been litigated in the Fifth and Eighth Circuits and the validity of the regulation has been sustained by each court.

Lamont vs. Commissioner, 8th Circuit, 120 Fed. (2d) 996.

Sneed vs. Commissioner, 5th Circuit, 119 Fed. (2d) 767.

Crabb vs. Commissioner, 5th Circuit, 119 Fed. (2d) 772.

In none of those cases, however, did the taxpayer show the exaction of a severe penalty over and above the amount of tax savings resulting from use of the deduction.

3. The Circuit Court of Appeals, in Deciding That Amounts Equal to Depletion Deductions of Prior Years Must Be Included in Gross Income in the Year of Cancellation of Lease in Spite of the Fact That the Deductions Did Not Offset Income or Reduce Income Tax, Has Decided an Important Question of Federal Income Tax Law Which Has Not Been, But Should Be, Settled by This Court.

The Circuit Court held that the deduction of $4,958.05 taken by Bessie P. Douglas in 1933, which did not serve to offset taxable income or to reduce taxes in that year was nevertheless includible in gross income for the year of termination of the lease.[1] Its decision was based upon its previous decision in the case of *Harwick vs. Commissioner*, 133 Fed. (2d) 732, decided March 2, 1943 (R. 87, 93). This court granted certiorari in the *Harwick* case on June 14, 1943, Nos. 930-933.

The Circuit Court had previously sustained the regulation here involved on the ground that where the deductions had served to reduce income taxes in prior years it was only fair to recover the tax in the year of termination. *Lamont vs. Commissioner, supra.* Yet, when confronted with a case where the deduction was of no tax benefit it nevertheless sustained the regulation upon the authority of the *Harwick* case, *supra.*

The *Harwick* case involved amounts received in 1939 upon rescission of a stock purchase. The Eighth Circuit Court of Appeals held that a charge-off of capital loss prior to

[1]The principle here involved likewise applies to the 1934 deduction of Bessie P. Douglas and to the 1932 deduction of Estate of Charles H. Robinson.

1939, which did not result in tax benefit, closed the capital transaction and made the recovery in 1939 taxable income.

The same reasons for granting certiorari in the *Harwick* case, *supra*, together with the prevalent litigation regarding "tax benefit" theories justify the granting of certiorari in this case.

It is not believed that the recent decision of this court in the *Virginian Hotel Corporation vs. Commissioner*, ... U. S. ..., decided June 7, 1943, has resolved the question here involved. That decision apparently turned on the question of the definition of the word "allowed" as provided by Section 113(b)(1)(B) of the Revenue Act of 1936, hereinbefore quoted. In these cases an item of alleged gross income is involved rather than a deduction. In these cases past tax benefit has been made the very justification for the validity of Article 23(m)-10(c). *Lamont vs. Commissioner*, 120 Fed. (2d) 996. Yet the regulation has been extended to a case where there has been no past tax benefit.

CONCLUSION

For the reasons stated your petitioners respectfully pray that writs of certiorari issue to enable this court to review the judgments of the Circuit Court of Appeals in these cases.

Respectfully submitted,

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Dated: June 25th, 1943.

FILED
Office
FEB 15

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 130

BESSIE P. DOUGLAS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

No. 131

BESSIE P. DOUGLAS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

No. 132

ESTATE OF CHARLES H. ROBINSON, NORTHWESTERN NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, JESSIE P. ROBINSON, ET AL., ETC.,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE.

No. 133

BERNICE B. DALRYMPLE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

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INDEX

	Page
Opinions of the Courts Below	2
Grounds Upon Which Jurisdiction Is Invoked	2
Statement of the Case	2
Specifications of Error	6
Argument	8
I. Introduction	8
II. The Untaxed Royalties of Prior Years Were Capital Recoveries in Those Years Under Sections 23(m), 114(b)(1), and 113(b)(1)(B), Resulting in Permanent Reduction of Basis and Hence Cannot Be Treated as Income for Any Year or Years; Article 23(m)-10(c), Regulations 94, Is Therefore Wholly Invalid	14
III. The Untaxed Royalties Were Received In Separate Annual Installments In Each of Eight Prior Years; None Was Received in 1937; Even If They Are Income, Treating Them As If All Received In 1937 Is Not In Accord With Fact and Violates Sections 23(m), 41 and 42, Resulting In Hardship and the Practical Denial of the "Reasonable Allowance For Depletion"; Article 23(m)-10(c) Is Therefore Wholly Invalid	31
IV. Assuming This Court Should Hold the Regulation Valid, It Should Not Be Applied to Deductions Taken When the Regulation Was Not In Effect	59
V. Depletion Deductions Resulting In No Tax Reduction When Taken Should Not Be Included In Gross Income In the Year of Termination of Lease	61
VI. The Regulation Was Not Validated By Reenactment of the Revenue Acts	64
VII. The Circuit Court of Appeals Had Full Jurisdiction to Reverse the Board and Should Have Done So On the Ground That the Board's Decision Was Contrary to Law.	68

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Barnett, Grace M. (1939), 39 B. T. A. 864. 10, 32, 37, 46, 47, 49, 60, 69

Blum vs. Helvering (U. S. C. A. for D. of C.—1934), 74 F. (2d) 482 33

Boeing vs. Owsley, 122 Minn. 190 26

Bromley vs. McCaughn, 280 U. S. 124, 84 L. Ed. 226 46

Burnet vs. Harmel (1932), 287 U. S. 103, 77 L. Ed. 199 26

Burnet vs. Sanford & Brooks Co. (1931), 282 U. S. 359, 51 S. Ct. 150, 75 L. Ed. 383 ..... 32, 40, 42, 48

Burnet vs. Thompson Oil & Gas Co. (1931), 283 U. S. 301, 75 L. Ed. 1049, 51 S. Ct. 418 ..... 27, 40

Cleveland Ry. Co. vs. Commissioner, 36 F. (2d) 347 34

Commissioner vs. Gooch Milling Co. (U. S.—1943), 88 L. Ed. (Adv. Sheet No. 3) 140, 64 S. Ct. 184 31

Commissioner vs. Heininger (Dec. 20, 1943), ... U. S. ..., 88 L. Ed. (Adv. Sheet No. 4) 197, 64 S. Ct. 249 69

Page

Cooper, A. T. (1927), 7 B. T. A. 798; Acq., VII-1 C.B. 1 ..... 9, 10, 59, 60, 61, 64
Crabb, Delores (1939), 41 B. T. A. 686 10
Crabb vs. Commissioner (C. C. A.—5th), 119 F. (2d) 772 ..... 11, 46
Dobson vs. Commissioner (Dec. 20, 1943), ... U. S. ..., 88 L. Ed. (Adv. Sheet No. 4) 179, 64 S. Ct. 239 ..... 56, 62, 63, 68
Dobson vs. Commissioner (Sub. nom. Harwick vs. Commissioner), 133 F. (2d) 732 ..... 61, 63
Griffiths vs. Helvering (1939), 308 U. S. 355, 84 L. Ed. 319, 60 S. Ct. 277 55
Harwick vs. Commissioner (1943), 133 F. (2d) 732 61
Helvering vs. Griffiths (1943), ... U. S. ..., 87 L. Ed. (Adv. Sheet No. 10) 597, 615, ... S. Ct. 61, 67
Helvering vs. American Chicle Co. (1933), 291 U. S. 426, 78 L. Ed. 891, 54 S. Ct. 460 52
Helvering vs. Hallock (1940), ... U. S. ..., 84 L. Ed. 383 65-66
Helvering vs. American Dental Co. (1943, ... U. S. ..., 87 L. Ed. (Adv. Sheet No. 10) 574, ... S. Ct. 52
Herring vs. Commissioner (1935), 293 U. S. 322, 79 L. Ed. 389, 55 S. Ct. 179 ..... 10, 14, 15, 16, 24, 29, 30, 44, 46, 49, 50
Hull vs. Commissioner (C. C. A.—4th), 87 F. (2d) 260 33
Ilfeld, Charles, Co. vs. Hernandez (1934), 292 U. S. 62, 68, 78 L. Ed. 1127, 1131, 54 S. Ct. 596 55
Knapp, Kittie A. (1927), 7 B. T. A. 790; Acq., VII-1 C.B. 17 ..... 9, 10, 59, 60, 61, 64
Lamont, John D. (1940), B. T. A. Memo. op. Aug. 29, 1940, Docket No. 94,875, 1940 C. C. H. Decision No. 11,298-D 10, 11
Lamont vs. Commissioner (C. C. A.—8th), 120 F. (2d) 996, 998. ..... 11, 12, 32, 37, 46, 47, 55, 59
Langdon-Warren Mines, Inc., vs. Reynolds (D. C.—Minn.—1943), 52 F. Supp. (Adv. Sheet No. 6) 512; 43-3 U. S. T. C., Par. 9534 47
McCahill vs. Helvering (1935, C. C. A.—8th), 75 F. (2d) 725, 728 19
Maryland Casualty Company vs. United States, 251 U. S. 342 52
Manhattan General Equipment Co. vs. Commissioner (1936), 297 U. S. 129, 134, 80 L. Ed. 538, 56 S. Ct. 397 65
Murphy Oil Co. vs. Burnet (1932), 287 U. S. 299, 77 L. Ed. 318, 53 S. Ct. 161 ..... 10, 14, 15, 16, 24, 45, 46, 49, 50, 58, 69
Northwestern States Portland Cement Co. vs. Huston, Collector (C. C. A.—8th, 1942), 126 F. (2d) 196 ..... 31, 33, 48
Shawmut Company (1940), B. T. A. Memo. op. Aug. 29, 1940, Docket No. 96,310, 1940 C. C. H. Decision No. 11,301-G 10, 11
Shawmut vs. Commissioner (C. C. A.—8th), 120 F. (2d) 996 11
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Sneed, J. T., Jr. (1939), 40 B. T. A. 1140 10
Stanton vs. Baltic Mining Co. (1915), 240 U. S. 103 26
State vs. Evans, 99 Minn. 220 26
State vs. Royal Mineral Assn., 132 Minn. 232 26

Page

Stratton's Independence vs. Howbert (1913), 231 U. S. 399..... 26
Sugar Creek Coal & Mining Co. (1934), 31 B. T. A. 344..... 56
United States vs. Kirby Lbr. Co. (1931), 284 U. S. 1, 76 L. Ed. 131, 52 S. Ct. 4..... 52
United States vs. Scott & Sons, Inc. (C. C. A.—1st, 1934), 69 F. (2d) 728, 732..... 56
Virginian Hotel Corp. vs. Commissioner (1943), 319 U. S. 523, 87 L. Ed. 1149, 63 S. Ct. 1260.....24, 54, 58
Von Baumbach vs. Sargent Land Co. (1916), 242 U. S. 503..... 26
Woolworth Co., F. W. vs. United States (C. C. A.—2nd, 1937), 91 F. (2d) 973..... 65

STATUTES AND REGULATIONS CITED

Statutes:

Revenue Act of 1913, Section II(G)(b)..... 26
Revenue Act of 1916, Section 5(a)(8th)(b)..... 27
Revenue Act of 1918, Section 214(a)(10)..... 28
Revenue Act of 1926, Section 1003(b)..... 68
Revenue Act of 1934, Section 12(b)..... 62
Revenue Act of 1936, C. 690, 49 Stat. 1648:
Section 12..... 43
Section 23(m).....6, 7, 8, 15, 16, 18, 19, 20, 21, 23, 25, 26, 31, 41, 44, 49, 51, 54, 62, 63
Section 41.....7, 10, 11, 41, 42, 43, 59
Section 42.....7, 10, 11, 33, 34, 41, 42, 43, 59
Section 111(a)..... 22
Section 113(a)..... 17
Section 113(b)(1)(B).....6, 7, 11, 15, 16, 17, 22, 23, 25, 30, 49, 50, 51, 55, 58
Section 114(a)..... 17
Section 114(b)(1).....6, 7, 11, 15, 16, 17, 22, 23, 25, 30, 58
Section 293(a) and (b)..... 13
Internal Revenue Code, Section 272(g)..... 31
Internal Revenue Code, Section 1141(c)(1)..... 68
Revenue Act of 1942, Section 116; 56 Stat. 798, 812, C. 619; 26 U. S. C. A., 1942 Supp., Sec. 22 (now Section 22(b)(12) I. R. C.)..... 56
Internal Revenue Code, Section 22(b)(12).....56, 57, 62

Treasury Regulations:

Regulations 45 (Preliminary Ed.—1918 Act), Article 215...9, 29
Regulations 45, Article 216..... 28
Regulations 45 (1920 Ed.—1918 Act), Article 215(d).....9, 29
Regulations 62 (1921 Act), Article 215..... 9
Regulations 65 (1924 Act), Article 216..... 9
Regulations 69 (1926 Act), Article 216..... 9
Regulations 74 (1928 Act), Article 236.....9, 60, 64
Regulations 77 (1932 Act), Article 230..... 9
Regulations 86 (1934 Act), Article 23(m)-10..... 9

Page

Regulations 94:
Article 22(a)-14 52
Article 23(m)-10(b) 15, 16, 49, 50
Article 23(l)-5 54
Article 23(m)-10(c) 4, 5, 7, 8, 9, 10, 13, 19, 21, 22, 23, 25, 31, 34, 38, 40, 41, 42, 44, 45, 47, 49, 51, 58, 61, 64, 69
Article 23(m)-11 ..... 53, 55
Par. 48, p. 493 13
Article 113(b)-1 16
Regulations 101 (1938 Act), Article 23(m)-(10) 9
Regulations 103 (I. R. C., as amended by 1940 Revenue Acts), Section 19.23(m)-10 9
Regulations 111 (I. R. C., as amended by Revenue Act of 1942) Section 29.23(m)-10(c) 9, 64
Regulations 111, Section 29.22(b)(12)-1 (b)(2) 57, 62

Rulings of Commissioner:
A. R. R. 1147, I-2 C.B. 138 12
Acq. Knapp, 7 B. T. A. 790, VII-1 C.B. 17 ..... 9, 10, 59
Acq. Cooper, 7 B. T. A. 798, VII-1 C.B. 1 ..... 9, 10, 59
G. C. M.—14448, XIV-1 C.B. 98 ..... 29-30, 61
Withdrawal of Acq. XI-2 C.B. 14 and 12 ..... 10, 61

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 130

BESSIE P. DOUGLAS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

No. 131

BESSIE P. DOUGLAS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

No. 132

ESTATE OF CHARLES H. ROBINSON, NORTHWESTERN NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, JESSIE P. ROBINSON, ET AL., ETC., *Petitioners,*

vs.

COMMISSIONER OF INTERNAL REVENUE

No. 133

BERNICE B. DALRYMPLE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

PETITIONERS' BRIEF

OPINIONS OF THE COURTS BELOW

The opinion of the Board of Tax Appeals (now the Tax Court of the United States) in all of these cases is reported in 46 B. T. A. 943 (R. 44). The Circuit Court of Appeals for the Eighth Circuit decided these cases in a single opinion which is reported at 134 F. (2d) 762 (R. 75).

GROUNDS UPON WHICH JURISDICTION IS INVOKED

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938. The judgments of the United States Circuit Court of Appeals for the Eighth Circuit were entered on April 7, 1943 (R. 83, 84, 85). A consolidated petition for writs of certiorari was filed in this Court by the taxpayers, on July 1, 1943 (R. 85), and certiorari was granted by this Court on January 10, 1944 (R. 85, 86).

STATEMENT OF THE CASE

The stipulated facts (R. 36-43) in each of these cases, which cases were consolidated for hearing and decision in the Board, in the Circuit Court of Appeals, and in the petition for certiorari in this Court, together with the facts alleged and admitted in the pleadings, were adopted by the United States Board of Tax Appeals as its findings of fact (R. 45-46). Since, with respect to the major issue, the facts and principles are not materially different, we shall for brevity state the facts in the case of petitioner, Bessie P. Douglas (Nos. 130-131).[1]

[1]The estate of Charles H. Robinson (No. 132), and Bernice B. Dalrymple's (No. 133), transferor, Irene B. Robinson Cirkler, were co-owners of the mine with Mrs. Douglas (Nos. 130-131). With respect to the main issue, the facts are substantially identical except that the estate became co-owner of the land upon the death of Charles H. Robinson, Aug. 16, 1932, so that in No. 132 deductions from 1932 to 1936 are involved instead of deductions from 1929 to 1936 as in the other two appeals. The facts of Nos. 132 and 133 are briefly stated in the stipulation of fact (R. 36-43).

In and prior to 1929, Bessie P. Douglas was the owner of an undivided one-half interest[2] in an iron mine situated in Minnesota from which some ore had been removed (R. 36, 46). On July 1, 1929, she and her co-owners leased the mine to the Republic Steel Corporation for a term of 30 years, commencing on that date (R. 36, 46).

In each of the eight years from 1929 to 1936, inclusive, Bessie P. Douglas received advance minimum royalty payments (R. 37, 46). By terms of the lease[3] these payments were required to be paid by the mining company annually whether ore was extracted or not (R. 46). Advance royalties paid were to be applied to iron ore later mined and shipped (R. 46).

For each year from 1929 to 1936, Bessie P. Douglas filed her Federal income tax return on the cash basis (R. 43, 46). For each year she included in her gross income the full amount of advance royalty received by her in that year (R. 37, 46). For each year she deducted therefrom an allowance for depletion computed on the cost basis (R. 37, 46), which the Commissioner reviewed and allowed (R. 37, 46).

In 1937, the mining company rendered written notice cancelling the lease pursuant to its terms (R. 36, 46). It had mined and shipped no iron ore during the life of the lease (R. 36, 46). For the year 1937, Bessie P. Douglas filed her

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[2]Charles H. Robinson owned an undivided one-sixth interest. His executors are petitioners in No. 132. Irene B. Robinson Cirkler owned an undivided one-sixth interest. The transferee of her estate, Bernice B. Dalrymple, is petitioner in No. 133. Adeline Morse owned the remaining interest. Her executors did not appeal from the Board.

[3]A typewritten copy of the lease and amendment thereto was attached to the Stipulation of Fact as Exhibit A.—See Par. A. 2. of Stipulation (R. 36). Because of the undue length of these documents and because it was deemed that the material provisions thereof were separately stated in the stipulation, they were omitted from the printed record in the Circuit Court of Appeals (R. 72). They were, however, a part of the record certified from the Board of Tax Appeals to the Circuit Court of Appeals (R. 71). If, for any reason, this Court may desire to see said lease as amended as an aid to the proper disposition of this case, taxpayers are willing that the same be brought before this Court in such manner and form as the Court may direct.

income tax return and did not report again as gross income for that year the untaxed portion of the royalties received and included in gross income in the prior years 1929 to 1936 (R. 37).

Upon review of her return for 1937, the Commissioner determined a deficiency based upon her failure to include in 1937 gross income sums totaling $53,299.03 (R. 14, 15, 46-47), equalling the aggregate depletion deductions of prior years, and consisting of the untaxed portions of royalty received in separate annual amounts in each of the eight years preceding 1937.[4] Accompanying this addition to 1937 income, was an upward revision of taxpayer's basis in the amount of $53,299.03 (R. 14-15). These two actions and the resultant deficiency in tax give rise to the issues of this case.

The assessed tax due to inclusion of these sums in gross income of 1937 is $26,545.30.[5] The aggregate tax reduction due to depletion deductions in the eight years prior to 1937 was $6,923.51 (Stipulation of Fact. Pars. B.9 and B.11, R. 37-38). The tax assessed for one year is $19,621.79 in excess of the total tax savings spread over eight years.

The actions of the Commissioner in (1) raising basis, and (2) allocating these amounts to 1937 gross income, were taken pursuant to Article 23(m)-10(c), Regulations 94, which provides as follows:

> "If for any reason any such mineral lease expires or terminates or is abandoned before the mineral which has been paid for in advance has been extracted and removed, the lessor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but

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[4]Certain other adjustments to gross income were made, but the deficiency attributable to them is not in controversy here (R. 14, 15).

[5]This is simply a mathematical computation made by deducting the $53,299.03 from the net income of $100,559.14 claimed by the Commissioner to be the correct net income (R. 15), leaving $53,260.11 as the net income claimed to be correct by petitioner. Applying the 1937 rates to $53,260.11 we find the total tax liability to be $9,954.03, or $26,545.30 less than the $36,499.33 claimed by the Commissioner.

not removed, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned."

Petitioner resisted the assessment on the grounds that the regulation was without authority of law, was in conflict with pertinent provisions of the statute, and was wholly unreasonable in practical operation and result. If the regulation is wholly invalid, as we believe it to be, the case was and should have been at an end.

If the regulation was held valid, two other issues arose involving the applicability of the regulation (1) to depletion deductions in prior years which resulted in no reduction in petitioner's tax, and (2) to all deductions prior to 1932 which were taken by petitioners in years when Article 23(m)-10(c) had been declared invalid by two decisions of the Board of Tax Appeals and was revoked by the Commissioner's published acquiescence in these decisions.

The Board of Tax Appeals held the regulation valid as to all deductions except the deduction taken by Mrs. Douglas in 1933, which resulted in no offset of income and in no reduction in tax (R. 53). It distinguished the Douglas deduction of 1934 and the Robinson (No. 132) deduction of 1932, portions of each of which resulted in no reduction of tax but did result in offset of income (R. 50-53).

Taxpayers appealed from the decision of the Board holding the regulation valid as to any of the prior deductions. The Commissioner appealed in the Douglas case from that portion of the Board's decision which held the regulation invalid as applied to non-tax-saving deductions of prior years.

The cases were consolidated before the Circuit Court of Appeals for the Eighth Circuit and on April 7, 1943, that court entered the following decision (R. 75—134 F. (2d) 762):

As to the appeals taken by the taxpayers, the Court affirmed the decision of the Board, holding that an amount equal to the prior depletion deductions constituted income in 1937 (R. 76-81).

As to the appeal taken by the Commissioner, the Court reversed the decision of the Board, asserting that the fact that the depletion deducted in prior years effected no reduction in taxable income, did not render the regulation invalid as applied to such non-tax-saving deduction (R. 81-82).

Taxpayers filed petitions for certiorari in this Court on July 1, 1943 (R. 86), which were granted on January 10, 1944 (R. 85, 86).

SPECIFICATIONS OF ERROR

I.

In holding that, under the Revenue Act, it is within the power of the Commissioner of Internal Revenue, by regulation, to adjust taxpayer's basis upwards by the amounts of the depletion deductions taken from 1929 to 1936 and to require the inclusion of corresponding amounts in the gross income of the year in which a mining lease terminated (1937), without production, the Circuit Court of Appeals erred in that the amounts of royalty received in prior years allocated to depletion by Section 23(m), cannot be taxed as income because they were capital recoveries in those prior years, under Sections 23(m), 114(b)(1) and 113(b)(1)(B), resulting in permanent reduction of basis, and, hence, cannot be treated as income for any year or years.

II.

In holding that any of the amounts equal to depletion deductions taken from 1929 to 1936 constitute taxable income for 1937, the Circuit Court of Appeals erred in that the untaxed royalties were received in separate annual installments in each of eight prior years; none was received in 1937; even if they are income, treating them as if all received in 1937, is not in accord with fact and violates Sections 23(m), 41 and 42, Revenue Act of 1936, resulting in hardship and the practical denial of the "reasonable allowance for depletion"; even if such amounts can be treated as 1937 income by reason of Article 23(m)-10(c), Regulations 94, the deductions of 1929, 1930 and 1931 cannot be so treated because the regulation was revoked when such deductions were taken.

III.

In holding that amounts equal to depletion deductions of prior years which produced no tax benefit must be included in gross income in the year of cancellation of the lease, the Circuit Court erred in that the amounts of royalty received equal to such depletion deductions were allocated to capital under Sections 23(m), 114(b)(1) and 113(b)(1)(B) in such prior years, and there is nothing in the statute or in the events of the taxable year 1937 or of prior years justifying or requiring a change in the status of such amounts from capital to income, nor was there any recovery in 1937.

ARGUMENT

I. Introduction.

The two central facts upon which the decision of this case rests are (1) there is no specific statutory authorization for Article 23(m)-10(c),[6] and (2) there are statutory provisions specifically forbidding the acts done pursuant to Article 23(m)-10(c). There is a specific statutory mandate to give the taxpayer a "reasonable allowance for depletion." Such reasonable allowance is "in all cases to be made under rules and regulations to be prescribed by the Commissioner." Section 23(m), Revenue Act of 1936.[7]

As a part of the regulations thus authorized, the Commissioner promulgated Article 23(m)-10(c). Upon the termination of a mining lease, where no ore is mined, the Commissioner claims to have authority to do two things: (1) Raise the taxpayer's basis from its depleted level by the amount of the aggregate depletion deducted in prior years; (2) Assign a corresponding amount to the income of the single year of termination.

We assert that the authority for either of these acts is totally lacking in the statute, and that doing either of these acts conflicts with specific statutory provisions. By thus violating the statute, the Commissioner inflicts a totally unjustified penalty on the taxpayer. And this inequitable result is the result which the statutory provisions, to be hereinafter discussed, were designed to prevent.

If we are right on either of our main points we are entitled to full relief. Even if we are wrong on both of our main points, two other factors entitle us to partial relief.

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[6]Article 23(m)-10(c) of Regulations 94, under the Revenue Act of 1936. To avoid needless repetition, citation of this article of the Regulations will refer to Regulations 94 unless the context indicates otherwise.

[7]The Revenue Act of 1936, as amended, is the statute applicable to this case. Hereinafter all statutory citations will be the Revenue Act of 1936 unless otherwise stated.

Thus, even if Article 23(m)-10(c) be held valid (which we do not for a moment concede), partial relief should be granted because:

1. Article 23(m)-10(c) was revoked during 1929, 1930 and 1931, when these taxpayers took their deductions for depletion. The Board of Tax Appeals had held the regulation invalid and the Commissioner had acquiesced. He withdrew acquiescence in 1932.
2. One of the deductions effected no tax reduction in the year when taken. Portions of two other deductions effected no saving when taken.

Article 23(m)-10(c) first crept into the regulations as Article 215 of Regulations 45 (Preliminary Edition), promulgated April 17, 1919, under the 1918 Revenue Act.[8] After promulgation, the forerunners of Article 23(m)-10(c) of Regulations 94 went to sleep until they were attacked in 1927 in the *Knapp* and *Cooper* cases.

Kittie A. Knapp (1927), 7 B. T. A. 790; Acq., VII-1 C. B. 17.

A. T. Cooper (1927), 7 B. T. A. 798; Acq., VII-1 C. B. 1.

In no uncertain language the Board of Tax Appeals held Article 215(d) of Regulations 45 (1920 Edition) beyond the power of the Commissioner.

> "In our view of the case the action of the respondent in requiring the inclusion in income for 1919 of any part of the difference between the depletion deductions allowed in prior years and the actual depletion sustained in those years, is without authority of law, and the regulations permitting or requiring such procedure are to that extent invalid."
>
> *Kittie A. Knapp* (1927), 7 B. T. A. 790, 792.

[8]Note: There have been changes in wording of this Regulation but the substance has remained intact throughout. Corresponding provision of all subsequent Regulations are as follows: Sec. 29.23(m)-10, Reg. 111 (1943); Section 19.23(m)-10 of Reg. 103 (1940), as amended by T.D. 4968, 1940-1 C.B. 43; and T.D. 5210, 1943-2-11316; Art. 23(m)-10 of Reg. 101 (1938), as amended by T.D. 4960, 1940-1 C.B. 28, Reg. 94 (1936) and Reg. 86 (1934); Art. 230 of Reg. 77 (1932); Art. 236 of Reg. 74 (1928); Art. 216 of Reg. 69 (1926) and Reg. 65 (1924), as amended by T.D. 3938, V-2 C.B. 117, and Art. 215 of Reg. 62 (1921) and Reg. 45, as amended by T.D. 3107, 4 C.B. 196, and T.D. 3938, V-2 C.B. 117.

In these decisions the Commissioner acquiesced. Acq., VII-1 C. B. 17; Acq., VII-1 C. B. 1.

Thus, it was thought the regulation was dead. But along came the case of *Murphy Oil Co. vs. Burnet* (1932), 287 U. S. 299, 77 L. Ed. 318, 53 S. Ct. 161 (wherein the point was not in issue) and, on the basis of a reference in the opinion to the regulation,[9] the Commissioner, in 1932, again pulled the regulation out of the hat by withdrawing acquiescence in the *Knapp* and *Cooper* cases. XI-2 C. B. 14; XI-2 C. B. 12.

Then, in the case of *Herring vs. Commissioner* (1935), 293 U. S. 322, 79 L. Ed. 389, 55 S. Ct. 179, the Supreme Court made it clear that the *Murphy Oil Co.* opinion was not a holding on the validity of Article 23(m)-10(c):

> "As to income tax liability in the year of termination of the lease, on account of bonus paid at the execution of the lease, if no mineral has then been extracted, we express no opinion."
>
> *Herring vs. Commissioner* (1935), 293 U. S. 322, 328, 79 L. Ed. 389, 393, 55 S. Ct. 179.

So the question rested until the regulation came before the Board of Tax Appeals in *Grace M. Barnett* (1939), 39 B. T. A. 864. The Board, believing the Supreme Court had held the regulation valid in the *Murphy Oil Co.* case, reversed itself and held the regulation valid on facts which did not disclose the glaring inequities lurking in it.[10]

In quick succession came the *Sneed, Crabb* and *Lamont* and *Shawmut Company* cases before the Board and the taxpayers fell before the precedent established by the *Barnett* case.

J. T. Sneed, Jr. (1939), 40 B. T. A. 1140.

Delores Crabb (1939), 41 B. T. A. 686.

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[9]Pp. 304, 306 of 287 U. S.; pp. 323, 324 of 77 L. Ed.

[10]The *Barnett* case involved only the transfer of untaxed bonus received in 1934 to the income of 1935. No cumulation of many years' income was involved. A violation of the statute resulted (Secs. 41 and 42) but no penal effect was shown to have been caused.

John D. Lamont (1940), B. T. A. Memo. Op. Aug. 29, 1940, Docket No. 94,875, 1940 C. C. H. Decision No. 11,298-D.

Shawmut Company (1940), B. T. A. Memo. Op. Aug. 29, 1940, Docket No. 96,310, 1940 C. C. H. Decision No. 11,301-G.

Undeterred, those four taxpayers went up to their respective Circuit Courts of Appeal and were subsequently denied relief in two sets of companion cases. *Lamont* and *Shawmut vs. Commissioner* (C. C. A.—8th), 120 F. (2d) 996; *Sneed vs. Commissioner* (C. C. A.—5th), 119 F. (2d) 767; *Crabb vs. Commissioner* (C. C. A.—5th), 119 F. (2d) 772. Apparently, neither court was fully advised of the basis provisions in the statute which were involved.[11] Both courts stated that the result was substantial justice.

But in the background was the case of the instant taxpayer, Mrs. Douglas. It came on for hearing before the Board on June 16, 1941, shortly after the Fifth Circuit decided the *Sneed* case (May 5, 1941) and shortly before the Eighth Circuit decided the *Lamont* case (June 24, 1941). The Board decision in the *Douglas* case was rendered April 14, 1942. It was based solely on precedent.

The *Douglas* case then went to the Circuit Court of Appeals in March, 1943, confronted with the nine-month-old *Lamont* case. The Court thereupon abandoned its argument that past tax benefit was the basic justification for sustaining the regulation (*Lamont vs. Commissioner,* 120 F. (2d) 996, 997-998), holding the regulation valid even as to deductions resulting in no tax benefit, and thus reversing the Board on this issue (R. 81-82). Confronted with Sections 41 and 42 of the Revenue Act, the Court abandoned its

[11]The Fifth Circuit made no reference to Section 114 (b) (1) in the Sneed case. It was advised of the bearing of Section 113(b)(1)(B) but dismissed it with the observation that no sale was involved. 119 F. (2d) 767, 772.

theory of "income-then-income-now" (*Lamont vs. Commissioner*, 120 F. (2d) 996, 998) and adopted the new theory of "capital-come-income" (R. 79, 80).

The *Douglas* case comes to this Court as a *de novo* question here. It presents the problem of what, if anything, must be done under the Revenue Act to the lessor when, after years of allowable depletion deductions against advance payments, a mining lease is cancelled by the operator and no ore has been extracted.

There are, as we see them, three possible alternatives which might have been chosen:

1. Continue to treat all past untaxed royalty as recovery of capital. Leave taxpayer's basis reduced to that extent. Make no adjustment to either capital or income upon lease termination. Let matters work themselves out in future taxable years through reduced deductions for depletion in event of future lease, through reduced basis deductible in event of future sale or abandonment.

   This we believe to be the plan enacted by the Revenue Act as we will later show. This is undoubtedly the fairest and most reasonable solution for both taxpayer and government and, in the end, fully squares accounts.

2. If the Revenue Act did not, as we contend, adopt the above solution, a regulation could require an increase in basis in the year of lease termination. Past untaxed royalty would then be reclassified from capital to income. The income would be taxable for the separate years in which received. Recomputation of tax liability would be in order for each prior year.[12] Taxpayer would pay to government the precise amount of tax saved in prior years.

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[12]This is not administratively difficult as suggested by the Fifth Circuit in *Sneed vs. Commissioner* (C. C. A.—5th), 119 F. (2d) 767, 770, 772. Witness our stipulation of fact (R. 42, 44, 46). "That would be most logical and accurate." *Sneed vs. Commissioner*, *supra*, p. 770. Further, this is precisely what the Commissioner would do if *clearly unlawful* depletion deductions were taken. A. R. R. 1147, I-2 C. B. 138.

Government and taxpayer are each restored to former position. Limitation statutes could be made inapplicable by conditioning the allowance in the first instance upon a waiver. If the basis provisions of statute did not prevent it, a regulation involving this plan would be reasonable, practical and workable. Though involving some injustice to taxpayer it would not be harsh. This would square accounts.

3. Adopt Article 23(m)-10(c). Raise taxpayer's basis. Include the "corresponding amount" in income of the year of lease termination. Cumulate all prior untaxed royalty and tax it as if all received in the year of termination.

   This was the Commissioner's solution. It is the most unfair and unreasonable of the three. In the average case it will result as it did here in extreme hardship for the taxpayer. This squares accounts and then for no reason exacts severe penalties worse than those prescribed for failure to file return, negligence or fraud. (See par. 48, p. 493, Reg. 94; Sec. 293(a) and (b), Revenue Act of 1936.) If the limitation statutes prevent the establishment of solution 2 above, they must apply with equal force here where they are, in effect, evaded by treating as income for 1937 income for 1929.

In our view of the case, the first solution is prescribed by statute covering just such contingency as here exists. It does not violate any part of the statute. The second solution involves violation of the basis provisions of the statute but might, were it not for such violation, be workable if adopted by regulation. The third solution violates the statute, is unreasonable, and is thoroughly in conflict with the fundamental spirit of the Revenue Law.

The basic issue for this case is to decide whether the regulation adopted by the Commissioner results in a "reasonable allowance for depletion" as prescribed by the Act, Section 23(m), and does not violate any other provisions of law. In our opinion, Article 23(m)-10(c) is both unreasonable and in conflict with statute, and therefore wholly invalid.

II. The Untaxed Royalties of Prior Years Were Capital Recoveries in Those Years Under Sections 23(m), 114(b)(1) and 113(b)(1)(B), Resulting in Permanent Reduction of Basis and Hence Cannot Be Treated as Income for Any Year or Years; Article 23(m)-10(c), Regulations 94, Is Therefore Wholly Invalid.

The Commissioner's case is built upon the fact that no ore was mined within the lease (R. 36, 46, 50). By reason of that fact he claims to have the authority to raise our capital account (basis) to its undepleted level of 1929, and by regulation to assign a corresponding amount to income of 1937.

In *Murphy Oil Co. vs. Burnet* (1932), 287 U. S. 299, 77 L. Ed. 318, 53 S. Ct. 161, this Court held that the receipt of an advance payment constituted at least a partial return of capital and hence was subject to depletion at least where later followed by production. Taxpayer there tried to treat all advance payments as income and to use his undepleted basis against royalties derived from actual extraction. The holding of the case is that depletion must be taken, if at all, in the taxable years when advance payments are received.

This holding was extended in *Herring vs. Commissioner* (1935), 293 U. S. 322, 79 L. Ed. 389, 55 S. Ct. 179, to require the allowance to be taken out of income in a taxable year when no production occurred and when there was no imminent production assured. The Court stated at pages 327-328 of 293 U. S.:

> "To condition the allowance on actual production, however small, or the imminent probability of production, and to deal in refinements as to the degree of probability of future production is in many cases to deny any deduction where the taxpayer elects to compute it under 204(c)(2) (flat percentage of gross income from the property) and permit it where he elects to compute it under 204(c) (on the basis of cost). But the nature and the purpose of the allowance is the same

in both cases, and we find neither statutory authority nor logical justification for withholding it in the one and granting it in the other; much less for making the decision turn upon the circumstance that no production is obtained within the year in which the bonus is paid."

The instant cases involve the logical extension of these two decisions to a case where advance payments are received and no production occurs within the lease under which such payments are received.[13] There is what we believe to be conclusive statutory support for such extension. It lies chiefly in the fact that Section 114(b)(1), relating to basis for depletion, and Section 113(b)(1)(B), relating to basis for determining gain or loss on sale, automatically and *unconditionally* reduce taxpayer's recoverable capital investment annually by the amount allowed but in no case less than the amount allowable. This annual reduction of remaining recoverable investment (adjusted basis) causes a statutory depletion in lieu of actual physical depletion of the mineral body. Thus, although the *allowance* of the deduction in the first instance, in the case of advance payments, is based upon anticipated future production, the *permanence* of the deduction is based upon a permanent reduction of basis.

The "reasonable allowance" against advance payments is granted by statute.

Section 23(m).

Article 23(m)-10(b), Reg. 94.

Murphy Oil Co. vs. Burnet (1932), 287 U. S. 299, 77 L. Ed. 318, 53 S. Ct. 161.

Herring vs. Commissioner (1935), 293 U. S. 322, 79 L. Ed. 389, 55 S. Ct. 179.

The deduction must be taken, if at all, in the years when

[13]It should be noted that, although the termination of a lease is a serious economic blow to the property, such termination, in the case of a proven mine, does not destroy anticipation of future production.

the advance payments are received. Taxpayer cannot postpone it to the day of actual extraction.

Article 23(m)-10(b), Reg. 94.

Murphy Oil Co. vs. Burnet (1932), 287 U. S. 299, 77 L. Ed. 318, 53 S. Ct. 161.

Herring vs. Commissioner (1935), 293 U. S. 322, 79 L. Ed. 389, 55 S. Ct. 179. (See particularly, p. 327 of 293 U. S.)

"A taxpayer is not permitted to take advantage in a later year of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate * * *." Art. 113(b)-1, Reg. 94. This statement is likewise applicable to depletion. Art. 113(b)-1, Reg. 94.[14]

Thus a statutory plan exists fully covering the instant cases. Section 23(m) provides the deduction. Sections 114(b)(1) and 113(b)(1)(B) provide the effect of taking or having the right to take the deduction. None of these sections indicates anything conditional about either the allowance or its effects. The reduction of basis takes the place of actual reduction of ore content, and fully protects government revenues in event the anticipated physical depletion does not occur. This results in certainty to both government and taxpayer and avoids the "attendant inconvenience of indefinite postponement of the allocation of the bonus to income and return of capital" which this Court held was a part of the meaning of the word "reasonable" as used in Section 23(m). *Murphy Oil Co. vs. Burnet* (1932), 287 U. S. 299, 77 L. Ed. 318, 53 S. Ct. 161.

Section 23(m) provides the deduction. Section 114(b)(1) defines the basis *for depletion* to be the same as provided by

[14]In this light the phrase "for which deduction has once been made" in Article 23(m)-10(b), Reg. 94, is a little misleading as it may be thought to indicate that taxpayers have the option to wait and take the deduction in years when ore is extracted. *Contra, Murphy Oil Co. vs. Burnet* (1932), 287 U. S. 299, 77 L. Ed. 318, 53 S. Ct. 161.

Section 113(b)(1)(B) which defines the basis *for determination of gain or loss on sale.* These are a part of the so-called "basis provisions" of the law and under them basis is defined with meticulous precision and in detail. *Sections 113(a), 113(b), and 114(a) and (b).* Considering the care with which Congress considered and prescribed the determination of basis, it is not to be lightly supposed that the Commissioner was authorized to depart from the words of the statute.

Section 114(b)(1) provides as follows:

"SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) * * *

(b) *Basis for depletion.*—

(1) GENERAL RULE.—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3) and (4) of this subsection. * * *"

Section 113(b)(1)(B) provides as follows:

"SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(b) *Adjusted basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) GENERAL RULE.—Proper adjustment in respect of the property shall in all cases be made—

(A) * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and

> tear, obsolescence, amortization and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. * * *"

It is to be noted that "Proper adjustment * * * shall in *all cases* be made." "Proper adjustment" with respect to depletion is defined by statute to be a deduction from basis "to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws." Nothing indicates that the reduction of basis is not final. Indeed, the plain meaning of the statute is that *capital* shall be deemed to have been recovered by the deduction for depletion, whether taken or not, to the extent allowed and in no case less than the amount allowable.

Dovetailing into this statutory plan is the second sentence of Section 23(m) which specifically provides that *even though subsequent events prove prior deductions for depletion to have been excessive, basis for depletion shall not be raised.*[15]

> "In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate *(but not the basis for depletion)* shall be revised and the allowance under this subsection *for subsequent taxable years* shall be based upon such revised estimate. * * *" (Italics ours.)

To our minds, this is the clincher on the question of Congressional intent. Here is an expressed legislative state-

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[15]We do not wish again to be met on this point by a government statement "Obviously the taxpayers have misread the statute" (Brief for Commissioner in the instant case before the Circuit Court of Appeals, p. 13). We do not say the quoted portion of the statute applies directly to our case. We cite it as a clear indication of Congressional intent in a case identical with ours in principle though not identical in detail. Its identity in principle is disclosed by the factual situation to which it does directly apply. We had thought that the determination of validity of a regulation involved determination of Congressional intent.

ment that basis is to remain fixed at the lower level. Past errors in allowance for depletion are to remain buried in the past.[16] Adjustment is to be made by spreading the depleted basis over the income of future taxable years.

This is how the statute applies. X, the owner of an iron mine, has a cost basis of $100,000. He takes depletion deductions on the cost basis against advance royalties for eight years from 1929 through 1936. No ore has been mined. The mine has an estimated 100,000 tons of ore in the ground. In 1937, the surface of the ground is stripped and a probable one million tons of ore is disclosed. Since X's cost remains the same, and must be spread over ten times as many units, his depletion should have been one-tenth of what it was. He has been getting ten times as much depletion deduction as he should have gotten. Nine-tenths of his depletion was allowed in those prior years on an assumption which proved in 1937 to have been false. If the Commissioner's reasoning is correct, the procedure prescribed by Article 23(m)-10(c) should be followed. X's *basis for depletion* must be restored to a higher level by adding back the excessive depletion of prior years. And a corresponding amount must be included in X's gross income for 1937, the year in which the error is discovered. X should be penalized for taking a proper deduction by cumulating his untaxed income for previous years and allocating that income to 1937, not to the year in which received.

But such is not the law. The procedure prescribed by Section 23(m) is simple, protects the Government and does not burden the taxpayer with an indefensible penalty. The

[16]Cf. "But where revision is made on account of information subsequently obtained,' the government cannot go back into the prior years and recover the excessive deductions, and neither can the taxpayer go back to the years 1929 and 1930, before the error was known, and, by obtaining deductions for those years, upset the basis for depletion as it stood in those years." *McCahill vs. Helvering* (1935, C. C. A.—8th), 75 F. (2d) 725, 728.

And "There is absolutely no authority for going back to the preceding tax years and changing the depletion allowances already deducted." *McCahill vs. Helvering* (1935, C. C. A.—8th), 75 F. (2d) 725, 728.

above quoted portion of Section 23(m) says excessive past depletion shall not be added back to the basis for depletion. The basis for depletion shall remain unchanged. The aggregate excessive past depletion cannot be added to the income of the year when the revised estimate of tonnage is made. But, depletion *for the future* shall be at a reduced rate computed by spreading the reduced basis for depletion over the greater number of tons now known to be in the ground. Note how the statute amply protects the Government's revenues by these two provisions, *i. e.*, (1) by keeping basis at a reduced level, and (2) by reducing the depletion factor for subsequent years. Under this procedure the Government gets a greater tax upon sale of the property. The lower the basis, the greater the taxable gain on sale. Likewise, it obtains a greater tax on future royalties. The lower the rate for depletion the greater the taxable portion of royalties received. Thus, the taxpayer who has enjoyed an undue benefit in the past bears the burden thereof in the future—but the burden is imposed in an orderly and sensible fashion based upon sound equitable principles.

Let us compare the cases of Bessie P. Douglas and X, the taxpayer, referred to in the above illustration. Both have taken a depletion deduction for a series of years. The allowance in each case is entirely proper and sanctioned by law. Both deductions, though proper, are based upon assumptions which appear true at the time the deduction is made, but later prove to be erroneous. Both Commissioner and taxpayer have acted for years on honest but in fact false premises. Bessie P. Douglas' deduction proved unwarranted[17] because physical exhaustion of the mine failed to materialize. X's deduction proved unwarranted because the ton-

[17] It is "unwarranted" only in the sense that the original allowance was based on anticipated production. That it is not unwarranted in the sense that ultimate production is required to make it permanent is illustrated by the statutory provisions previously referred to.

nage proved to have been underestimated. The discovery of error arises many years later. Termination of the lease without extraction of ore disclosed the error in the Douglas case. Discovery of additional tonnage without extraction of ore disclosed the error in X's case. The facts are so parallel one would never suspect the disparity in tax treatment. The statute, which expresses Congress' intent, prescribes that X shall suffer no penalty for the honest error, but he shall square accounts *in future taxable years*. The regulation, which purports to express Congress' intent, prescribes that Bessie P. Douglas shall square accounts in the year the error is discovered and in addition shall suffer a paralyzing penalty because her deduction, in the light of subsequent events, proved unjustified.

Article 23(m)-10(c) cannot really be held to interpret the statutory intent. *It clashes with the very section of the statute which it purports to interpret.* The truth is that Article 23(m)-10(c) violates the letter and spirit of Section 23(m) from which it must draw its authority. Congress has laid down in the second sentence of Section 23(m) what its concept of a "reasonable allowance for depletion" means in a case of excessive past depletion and the regulation is clearly contrary to that concept.

It is, therefore, the contention of petitioners that the deduction to which they are entitled and which they must take, if at all, in the year in which advance royalties are received, is an *absolute* deduction granted for depletion of their capital investment which, for Revenue Act purposes, had absolutely occurred and become fixed, under the Revenue Act, in the year in which the advance royalties were received. It is their contention that the depletion deduction, insofar as advance royalties or bonuses are concerned, is in no way dependent for permanence upon physical exhaustion of the property but is rather dependent upon a statutory

depletion in lieu of actual depletion. It is their contention that the statutory depletion occurs by terms of the Act each year and that each year the basis is fixed at its lower level and by express provisions of the Act[18] is placed beyond the power of the Commissioner to raise. In consequence of this, it is contrary to the Revenue Act for the Commissioner to raise the taxpayer's basis and compel the return of a "corresponding amount" as income in the year of termination. Congress has provided its own solution to the problem of depletion deductions against advance royalties by reducing the lessor's basis each year to the extent of the depletion allowable so that, after termination of the lease, gain or loss on a sale, or depletion on a new lease, must be computed upon the reduced basis. So far as the lessor's basis is concerned he has actually suffered depletion. The reduction of his basis is made a finality by the Revenue Act itself. The Commissioner of Internal Revenue cannot supplant the solution provided by Congress with a solution of his own.

Thus, if the mine lessor had sold the reversion before the lease terminated, the depletion would clearly have been absolute and tax would have been paid on the excess of the proceeds over the depleted basis. Sec. 111(a), Revenue Act of 1936. If the lease then terminates after the sale, Article 23(m)-10(c), if valid, would become applicable, and the vendor again would pay tax on the same return of capital. Clearly the vendee could not be held taxable upon prior deductions taken by the vendor.

The statute bases the allowance for depletion upon anticipated extraction of ore. Yet the statutory plan is complete and fully covers the case where a lease is subsequently terminated without extraction. The solution provided by statute is to leave things in *status quo*. Basis is not to be tampered with. No corresponding bookkeeping "credit" to in-

[18]Sections 114(b)(1) and 113(b)(1)(B).

come in the year of termination. Taxpayer is deemed to have recovered a portion of his investment and his reduced basis is all that remains to be recovered in the future years. Never will he recover more than his original basis. The plan embodied in the "reasonable allowance" part of Section 23(m) and the correlative Sections 114(b)(1) and 113(b)(1)(B), relating to reduction of basis fully covers the instant case and protects both the Government and taxpayer. There is in fact no hiatus in the statute requiring administrative regulation. Interstitial legislation will not fit where there is no interstice.

The misconception of the Treasury and of the courts below is based upon their failure to understand the nature of the deduction for depletion. The deduction is a two-edged sword. While one blade cuts down taxable income the other simultaneously cuts down taxpayer's recoverable investment. It permits the taxpayer to recover his investment out of what would otherwise be taxable income.[19] And that cutting down of remaining recoverable investment is the protection of the Government from just such contingency as occurred in this case. Thus, when Mrs. Douglas received $10,000 in royalties in 1932 it was all income constitutionally taxable. Congress granted her the right to consider $4,958.05 as recovery of capital. As such, it not only reduced her taxable income for 1932, it reduced her remaining recoverable capital by the same amount. Depletion is not comparable to

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[19]Royalties are taxable income under the XVIth Amendment and in the absence of a statutory deduction can be fully taxed. Without any statutory deduction for depletion, taxpayers would yet be able to recover investment by a deduction of cost upon a sale or abandonment. This would, however, be only a theoretical "recovery" unless taxpayer had some income sufficient to absorb the loss on sale or abandonment in the year in which the sale or abandonment occurred. The statutory deduction is in essence a device permitting recovery of capital in advance out of income from the property. Its purpose is to correlate the recovery of investment with the receipt of income, not leaving the taxpayer to the uncertain future "recovery" through taking a loss on sale or abandonment, not taxing him in full in the years when he receives that income and has no offsetting deduction. Article 23(m)-10(c) is the direct antithesis of the spirit of the law.

other deductions such as taxes paid, business expenses, and other like deductions which do not affect capital items and which if improperly taken cause a permanent loss of revenue to the Government. Rather, it is comparable to depreciation where excessive deductions reduce the capital base, and, upon discovery of error in a subsequent year, the capital base remains *reduced* and the Government recoups by reduced allowances in the future. This procedure is aptly illustrated by *Virginian Hotel Corporation vs. Commissioner* (1943), 319 U. S. 523, 87 L. Ed. 1149, 63 S. Ct. 1260, where, we assume that had depreciation deductions in prior years reduced taxable income, both majority and minority of this Court would have been in accord. Basis would have been reduced and future depreciation would consequently be reduced.

Thus, we believe that the statutory concept of depletion is to some extent different from the concept of actual exhaustion of physical property. This is illustrated by the *Murphy Oil Co.* and *Herring* cases where income from the property received in advance of extraction was held, partly or in full, return of capital. These cases hold that the allowance, at least in the first instance, is dependent only upon a *reasonable anticipation* of production. That statutory depletion differs from actual exhaustion is further illustrated by the fact that after recovery of all investment, actual exhaustion will not give rise to further statutory depletion. The question in this case is, when an event occurs, many years after the allowance, which shows that there will be no production under a given lease, did the original allowance sufficiently differ from actual production under the lease as not to require its retroactive disallowance? Our contention is that the original allowance, though based upon reasonable anticipation of production, was so related to the taxpayer's investment in the property that there is no neces-

sity for adjustment when that reasonable anticipation fails to materialize within a given lease. In other words, for purposes of the Revenue Act, it is not nearly so important that production did not follow anticipation within the life of the lease as it is that reduction of basis coincided with the deduction for depletion.

It is this point which Mertens speaks of when he states that depletion is correlated to income and not to production. *Mertens, Law of Federal Income Taxation* (1942), Vol. 4, Section 24.18. And this is the point covered when he says, concerning Article 23(m)-10(c):

> "Obviously, there is nothing in the abandonment or the termination of the lease that gives the landowner any income. On the contrary, such action results in the elimination of the value which he believed that he had retained under the royalty provision of the lease.
>
> Judge Hutcheson has pointed out the inconsistency of this practice with the general theory of depletion, in his vigorous dissenting opinion in the Crabb case. This practice has been approved by the Board and by the courts in all cases which have reached the courts to date. Nevertheless, the theory upon which such restoration is made, is at variance with the general theory of depletion as presently developed, and the Bureau's insistence upon such restoration prevents, to that extent, the development of a complete and logical theory of depletion correlated with income derived from minerals."
>
> *Mertens, Law of Federal Income Taxation* (1942), Vol. 4, Section 24.64.

We believe that Sections 23(m), 114(b)(1) and 113(b)(1)(B) contain in legislative form that "complete and logical theory of depletion correlated with income derived from minerals." And the Bureau has no right by its "insistence upon such restoration" to prevent the statutory operation of that theory in practice. The Circuit Court erred as a matter of law in sustaining the regulation.

We are fully borne out in this analysis of the statute by

its historical development. Section 23(m) was born out of the background of the advance royalty cases in which this Court held advance royalties to be fully taxable income.

Taxpayers had contended that receipt of advance royalty payments under mining leases, not materially different from that here involved, constituted sales of ore in the ground and that they were therefore entitled to deduct their cost or investment from the proceeds and pay tax only on the excess of selling price over cost. However, the Supreme Court held that there was no sale of ore in place, that advance royalty payments were in the nature of rent, giving the mining company only a license to mine. All receipts were therefore taxable income to the lessors under the XVIth Amendment and Congress could, if it chose, tax them in their entirety.

Stratton's Independence vs. Howbert (1913), 231 U. S. 399.

Stanton vs. Baltic Mining Co. (1915), 240 U. S. 103.

Von Baumbach vs. Sargent Land Co. (1916), 242 U. S. 503.

State vs. Evans, 99 Minn. 220.

Boeing vs. Owsley, 122 Minn. 190.

State vs. Royal Mineral Ass'n, 132 Minn. 232.

See also:

Burnet vs. Harmel (1932), 287 U. S. 103, 77 L. Ed. 199.

The Revenue Act of 1913 granted a depletion allowance based solely upon production but "not to exceed 5 per centum of the gross value at the mine of the output of the year for which the computation was made." Sec. II(G)(b), Revenue Act of 1913. This was admittedly too small an allowance to permit complete recovery of the taxpayer's capital

investment. See *Burnet vs. Thompson Oil & Gas Co.* (1931), 283 U. S. 301, 75 L. Ed. 1049, 51 S. Ct. 418. It applied only to actual royalty for ore mined and shipped. Advance minimum royalties were fully taxed.

Congress came to the rescue of recipients of actual royalty on ore mined and shipped by the *Revenue Act of 1916*, Section 5(a)(8th)(b), of which provided:

> "in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof, which has been mined and sold during the year for which the return and computation are made; such reasonable allowance to be made * * * under rules and regulations to be prescribed by the Secretary of the Treasury: provided, that when the allowances authorized * * * shall equal the capital originally invested, or in the case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made. * * *"

Here again production is the test. Depletion is synonymous with physical exhaustion. Yet, here is recognition of taxpayer's capital investment as the depletable base. Depletion is more directly tied to capital investment (basis) than to ultimate physical exhaustion because the statute provides that when that investment has been returned through depletion allowances the allowance ceases even though physical exhaustion continues.

This provision, however, left the recipients of advance royalty payments out in the cold. Their income came years in advance of their deductions. They paid taxes in full on their royalties when received. They were entitled to depletion deductions in the future when production commenced and the related income had already been taxed. The depletion deduction was useless unless they had other non-related income against which to offset the deduction. The function and purpose of the depletion allowance as finally

developed, *i. e.*, to permit the taxpayer to recover his investment out of income from the property free of income tax, was not yet enacted.

Congress completed the rescue in the *Revenue Act of 1918*, striking the requirement of actual production out of the law, thus permitting recipients of advance royalties or bonus to correlate their deductions with income:

> "In the case of mines * * * a reasonable allowance for depletion * * * according to the peculiar conditions in each case, based upon cost, including cost of development not otherwise deducted: Provided, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: * * * such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary * * *."
>
> Sec. 214.(a)(10), *Revenue Act of 1918*.

Here the true character of depletion under the Revenue Act, as a device to permit recovery of investment out of income from the property, became clear. Coming as it did out of the background of the advance royalty cases, it was clear that the statutory intent in striking the production requirement was to permit recovery of investment out of income from the property even where there was no production coincident with income—just a reasonable anticipation of production.

At no place in the 1918 Act did it appear that there was anything conditional about the allowance. The allocation of part of the income from the property to return of investment by Sec. 214(a)(10), and the limitation that when all capital was returned the allowance should cease, indicate an unconditional grant. See Art. 216, Reg. 45 (1918 Act).

So, in Regulations 45, issued April 17, 1919, under the Revenue Act of 1918, the Commissioner authorized a deduc-

tion for depletion against advance royalty payments. Article 215, Reg. 45. But, instead of recognizing the true function of the statutory allowance for depletion, he deemed it still tied to actual ultimate physical extraction and provided that, in the event the anticipated production failed to materialize within the existing lease, the deductions previously granted would be retroactively disallowed and the income previously received but allocated to capital should be taxed in the aggregate as income for the year the lease terminated. Article 215, Reg. 45 (Preliminary Edition); Article 215(d), Reg. 45 (1920 Edition).

In this we believe he erred. We assume that he thought the termination of a mining lease without extraction, after depletion deducted from income, gave the taxpayer an unwarranted advantage over the Government and that the statute did not cover the case. But he overlooked the fact that the statute fully protected the Government by causing an actual depletion of the taxpayer's basis. If taxpayer recovered a portion of his investment out of advance royalty payments he suffered a corresponding reduction of basis, and no second recovery would be available to him. Thus, even at that early date the statute had a well rounded plan for depletion allowances which fully covered the instant case. There was no need of this regulation.

Too much emphasis was placed on the fact that no ore was mined under the existing lease—too little on the fact that taxpayer's recoverable investment had been reduced. In this light, when the mining lease terminates, the advance royalties received in prior years take on the aspect of the bonus in *Herring vs. Commissioner* (1935), 293 U. S. 322, 79 L. Ed. 389, 55 S. Ct. 179. In that case, a bonus was received on execution of a lease, no production occurred within the taxable year, nor was there any practical assurance in that year of future production. G. C. M. 14448, XIV-1

C. B. 98. Yet, the court held that a part of the bonus constituted return of capital and the deduction therefore must be allowed.

In this light, Mrs. Douglas received a bonus of $107,500.00 in separate annual installments from 1929 to 1936. Of that bonus, $53,299.03 was capital return when received. The termination of the lease in 1937 was not a taxable event —it did not even remove the anticipation of future production. It could not retroactively change the character of proceeds from the property from capital to taxable income.

Herring vs. Commissioner (1935), 293 U. S. 322, 79 L. Ed. 389, 55 S. Ct. 179.

Section 113(b)(1)(B) and Section 114(b)(1).

As a result of the statute, if taxpayers herein should, after termination of the lease, sell their interests, or execute a new lease, their basis upon which to determine gain or loss, or the new depletion rate, is fixed by the Revenue Act at the lower level. And any attempt on the part of the Commissioner to change that basis is in violation of the express terms of Sections 114(b)(1) and 113(b)(1)(B). The Commissioner cannot by regulation change the basis as fixed by the Revenue Act itself.

Since taxpayers' capital to be recovered has been reduced absolutely by the Act, any attempt to tax them on the theory that no depletion has been suffered would be clearly unreasonable and unauthorized by statute. Taxpayers have not "gotten away with something." The Government side of the taxpayer-Government account is compensated for the depletion deductions by the reduction of taxpayers' depletable base.

This solution of the problem leaves the taxpayer and Government in the *status quo* of 1937. Taxpayer's income taxes for prior years remain what they were determined to be. Her

basis remains at the level to which her deductions in prior years had reduced it, and her income tax for the year of termination is computed on her true income and not on her income as inflated by legal fiction. This is the solution which harmonizes with the language, spirit and intent of the Revenue Act. This is the solution which does not violate the established Revenue Act theory of income tax computed on the basis of fixed annual accounting periods. This is the solution which keeps the books closed and looks to the future for adjustment. This is the solution which harmonizes precisely with the second sentence of Section 23(m). It is this solution which avoids the harsh operation of Article 23(m)-10(c). And for these reasons the contrary solution provided by regulation should be held error.

III. The Untaxed Royalties Were Received in Separate Annual Installments in Each of Eight Prior Years; None Was Received in 1937; Even if They Are Income, Treating Them as if All Received in 1937 Is Not in Accord With Fact and Violates Sections 23(m), 41 and 42, Resulting in Hardship and the Practical Denial of the "Reasonable Allowance for Depletion"; Article 23(m)-10(c) Is Therefore Wholly Invalid.

Only the income for the taxable year 1937 was before the Board of Tax Appeals. Internal Revenue Code, Sec. 272(g); *Commissioner vs. Gooch Milling Co.* (U. S.—1943), 88 L. Ed. (Adv. Sheet No. 3) 140, 64 S. Ct. 184.

If we were in receipt of income in years prior to 1937, that factor cannot be taken advantage of to increase our 1937 tax liability. Cf. *Northwestern States Portland Cement Co. vs. Huston, Collector* (C. C. A. 8th—1942), 126 F. (2d) 196.

Thus, if we should be held wrong in our contention that the advance royalties received in years prior to 1937, to the

extent allocated by the Revenue Act to return of capital, were irrevocably and unconditionally applied in reduction of basis, we are not wrong in the fact that the amounts involved were not received in 1937 (R. 37). Even if the Commissioner could raise the basis and retroactively reclassify these untaxed royalties as taxable income he cannot by regulation make them 1937 income.

Separate annual deductions were taken by taxpayers from 1929 to 1936. By reason thereof separate annual portions of royalty received went free of tax because they constituted an apparent return of capital. An aggregate of $53,299.03 in depletion deductions was taken by Bessie P. Douglas over eight taxable years. An aggregate of $53,299.03 royalty *received by her in separate annual amounts over eight taxable years* went free of tax. The Circuit Court held that the $53,299.03 untaxed royalty of eight consecutive years constituted gross income of the ninth year in which *none of it was received*.[21] There can be no clearer case of cumulation of the income of many years.

This Court held in *Burnet vs. Sanford & Brooks Co.* (1931), 282 U. S. 359, 51 S. Ct. 150, 75 L. Ed. 383, that an item of gross income received in a later year could not be drawn back to the year when related deductions were incurred. In effect, this Court held that, where there is no accrual, *the time for inclusion in income is the year in which the item is*

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[21] R. 79-80.

Also: "The Commissioner's position is not that he [Sneed] got the land back but that the occurrences in 1936 developed a change in status of so much of the money income received in 1926 as then went untaxed because it stood for an anticipated depletion of his oil reserve, and being a return of capital was not income subject to taxation. *Sneed vs. Commissioner* (C. C. A.—5th), 119 F. (2d) 767, 770.

Also: "The Regulation simply provides in effect that when • • • the tax is not paid on a portion of the proceeds • • • then the tax shall later be paid on that portion of the income on which it had not been paid." *Lamont vs. Commissioner* (C. C. A.—8th), 120 F. (2d) 996, 998.

Also: "Finally, the present case is analogous to a number of others, where, with or without a supporting regulation, an adjustment has been made during the taxable year *in which actually no income was received*." *Grace M. Barnett* (1939), 39 B. T. A. 864.

received. And that principle is clearly enunciated in that portion of Section 42 of the Revenue Act of 1936, which provides as follows:

> "The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, * * *."

The cases are legion in which this principle has been applied.[22]

In *Northwestern States Portland Cement Company vs. Huston* (C. C. A. 8th—1942), 126 F. (2d) 196, income received in 1916 and 1917 was held non-taxable in 1932 even though improper deductions were made in 1916 and 1917 in creating a reserve which was credited to surplus in 1932.

In *Hull vs. Commissioner* (C. C. A.—4th), 87 F. (2d) 260, income received in 1925 was held non-taxable in 1926 even though the taxpayer failed to report it in 1925 contending it was not income.

In *Blum vs. Helvering* (U. S. C. A. for D. of C.—1934), 74 F. (2d) 482, income received in 1924 was held taxable in 1924 even though received subject to a contingent liability to pay it out which became fixed and was paid in 1925 resulting in a great loss on the transaction viewed as a whole over the two years. The Court stated (at p. 483):

> "The Supreme Court has held over and over again that a taxpayer may not postpone the payment of the tax then due, in order to ascertain whether the final outcome of the transaction out of which the taxable profit accrued would ultimately result in a gain or a loss. Nothing is now better established than that the assessment of income taxes is on the basis of an annual accounting period, and while, as the Supreme Court has said, conceivably a different system might be devised by which the tax could be assessed wholly or in part on the basis of the finally ascertained result, Congress is not required

[22] For many cases and a general discussion of the time an item becomes income, see *Mertens, Law of Federal Income Taxation*, Vol. 2, Chapter 12. Particularly see Secs. 12.50, 12.14, 12.07, 12.05.

to, and has not adopted such a system. *Burnet vs. Sanford & Brooks Co.*, 282 U. S. 359, 365, 51 S. Ct. 150, 75 L. Ed. 383."

We think the same rule applies here to the Commissioner.

"The concept is fundamental that the law imposes the tax with reference to a fixed period of time. The income tax law is predicated upon annual periods; proving income for a period of years does not prove income for any one year. The annual period is, of course, a matter of necessity if the law is to be administered; it has been called the cornerstone of our tax structure. Naturally it gives rise to efforts of taxpayers to either defer or accelerate items of income or deductions, and the Treasury Department is not entirely free from an inclination to push items around from one year to another when it serves to increase the tax."

Mertens, Law of Federal Income Taxation, Vol. 2, Ch. 12, Sec. 12.06.

Amounts earned in 1918, 1919, 1920 and 1921, required by city ordinance to be held in a revolving fund for future dividends, could not be treated as income for later years but constituted income in separate annual amounts for each of the several years. *Cleveland Ry. Co. vs. Commissioner*, 36 F. (2d) 347.

We are aware of the fact that the cash basis is not immutable. Even the statute recognizes departures therefrom where necessary clearly to reflect income. *Section 42.* But Article 23(m)-10(c) requires a departure from the fundamental rule which causes the clearest possible case of distortion of income. Under it, $53,299.03 is held to be income for one year when, in fact, that amount was received in installments in each of eight separate years, that amount was never received all in one year, and none of it was received in the year for which it is taxed.

This case is the simple story of a taxpayer who took a depletion deduction on her income tax returns each year for

eight years. The law allowed her the deduction and the Commissioner approved it. The law further provided that if she did not take this deduction when she took it she must forego it forever. She could not wait and take it later when ore should actually be mined. By the deduction she saved in eight years $6,923.51.[23] Then, in the ninth year, an event occurred which disclosed for the first time that the reason for permitting the deduction would never materialize under the existing lease. She received notice of cancellation of the lease and no ore had been mined. The Commissioner in the ninth year imposed a tax of $26,550.65 on the untaxed royalties of eight previous years. He computed the tax in the following manner: All of her net income for 1937, exclusive of prior years' depletion, was $53,260.11.[24] To this he added a sum (*i. e.*, untaxed royalty) corresponding to her aggregate depletion deductions for eight consecutive years, $53,299.03 (R. 14). This raised her so-called 1937 net income to $106,559.14 (R. 14), *more than double* her true net income for 1937. The tax on $106,559.14 net income under the 1937 law is $36,499.33 (R. 15). The tax on $53,260.11 is $9,948.68.[25] Thus the tax due to inclusion of prior years' depletion is $26,550.65. This is the price the Commissioner asks of the taxpayer in a single year for her saving of $6,923.51 over the long stretch of eight prior years. The penalty is almost $20,000[26] for having exercised the privilege which Congress, not the Commissioner, granted to her.

The above is a simple but accurate statement of the case. The penalty is the consequence of a regulation promulgated by the Commissioner. The severity of the regulation and

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[23]$6,923.51 is the difference between her total taxes actually paid from 1929 to 1936 and the total taxes she would have had to pay had she not deducted depletion. See Stipulation of Fact, paragraphs B.9 and B.11 (R. 37 and 38).

[24]This is computed by deducting total past depletion ($53,299.03) from net income computed by the Commissioner ($106,559.14). See Record, p. 14.

[25]This is computed by applying the rates of 1937 to a net income of $53,260.11, which we assert was taxpayer's true net income for that year.

[26]To be precise, the penalty is $19,621.79.

the lack of common sense justification for its oppressive operation lead naturally to questioning its validity. Surely a regulation containing such potentially explosive material must have a sound basis of authority in the statute. And, surely, it must have a common sense reason for existing. The remainder of our brief is devoted to demonstrating that even if, contrary to our contention, an increase in basis is held to be authorized, this regulation is not only unauthorized by statute, but contrary to the statute, and that the common sense result which the regulation was designed to achieve is not in fact achieved in practical operation. Nothing supports our position more eloquently than the harsh and unreasonable result achieved by the regulation in this case.

1. Examination of the facts discloses that:

(a) All of the income[27] sought to be taxed herein was received prior to 1937.

(b) It was received in separate annual periods and is herein attempted to be taxed as though all received in 1937.

(c) The effect of such treatment is to inflict an unjustified penalty on the taxpayer.

We make the simple point that the income which the Commissioner proposes to tax as 1937 income is, in fact, not income at all for 1937. We make the point that the income scooped up by this regulation is part income for 1929, part for 1930, and so on up to 1936. None of it is income for 1937.

It should be borne in mind that all income *actually received in 1937* by Bessie P. Douglas has been reported and

[27]The word "income" is used here and in the remaining portion of this brief on the theory that this Court may hold, against our views, that an increase in basis is within the Commissioner's power. A corollary to the increase in basis is that the prior receipts are to be considered as income instead of capital as originally thought. But the question yet remains "For what years are they income?" We believe the statutory obstacles to cumulating these receipts into one year when none of them were received are insuperable.

taxed and is out of the issues of this case. The issue now under discussion is solely this: Can the Commissioner lawfully add to the income actually received in 1937 the sum of $53,299.03?

What is the income represented by this $53,299.03? And when was it received? The notice of cancellation of lease received in 1937 was not a check for $53,299.03. $53,299.03 is exactly the sum of royalty received which was rendered free from tax by depletion allowed from 1929 to 1936. Thus, it becomes clear that the income represented by the $53,299.03 added to the gross income of 1937 is in reality the untaxed portion of royalties received from 1929 to 1936.[28] Likewise, it becomes clear that the basic issue now under consideration is whether or not the Commissioner can lawfully add to the gross income of 1937 a cumulated total of royalties received and reported in gross income in each of eight years all prior to 1937.

A careful examination of the facts of this case will show clearly the time of receipt of the income which the Commissioner asserts must be taxed as 1937 income. The record of Bessie P. Douglas' royalties and depletion for the eight years appears as follows:[29]

	Royalty Received	Depletion Allowed	Net Taxable Royalty
1929	$ 2,500.00	$ 1,239.51	$ 1,260.49
1930	10,000.00	4,958.05	5,041.95
1931	10,000.00	4,958.05	5,041.95
1932	10,000.00	4,958.05	5,041.95
1933	10,000.00	4,958.05	5,041.95
1934	12,500.00	6,197.56	6,302.44
1935	22,500.00	11,155.61	11,344.39
1936	30,000.00	14,874.15	15,125.85
Total Depletion, 1929-1926		$53,299.03	

[28]This analysis of the facts is the same as that made by the Eighth Circuit in *Lamont vs. Commissioner* (1941), 120 F. (2d) 996, and by the Fifth Circuit in *Sneed vs. Commissioner* (1941), 119 F. (2d) 767, and by the Board in *Grace M. Barnett* (1939), 39 B. T. A. 864.

[29]R. 37, paragraphs B.6 and B.7 of Stipulation of Fact.

If her deduction for depletion be retroactively disallowed, her record would appear as follows:

	Royalty Received	Royalty Previously Taxed	Royalty Previously Untaxed
1929	$ 2,500.00	$ 1,260.49	$ 1,239.51
1930	10,000.00	5,041.95	4,958.05
1931	10,000.00	5,041.95	4,958.05
1932	10,000.00	5,041.95	4,958.05
1933	10,000.00	5,041.95	4,958.05
1934	12,500.00	6,302.44	6,197.56
1935	22,500.00	11,344.39	11,155.61
1936	30,000.00	15,125.85	14,874.15
Cumulated untaxed royalty, 1929-1936			$53,299.03

Three important facts are thrown into relief by the above illustrations: First, they show that the effect of taking the depletion deduction in the first place is simply to render free from tax a portion of the royalty received. This is on the theory that such portion is return of capital, not income. Second, they show that the effect of disallowing the depletion deduction is simply to remove the tax free status of the royalty. This is on the theory that it is all income, no return of capital. Third, and fundamental, neither the allowance nor disallowance can affect the fact that the income in question was not received in 1937. Those royalties were received in *separate annual* installments in each year from 1929 to 1936, inclusive.

The Commissioner's regulation cumulates this untaxed royalty received in annual units and includes in 1937 gross income the aggregate of $53,299.03. All of this amount was never received in one year, and none of it was received in 1937. By fiction the Commissioner has "transferred" the untaxed royalty received in 1929 to 1937. He has done likewise with each of the annual amounts of untaxed royalty for each of the subsequent years to and including 1936.

Let us turn to the words of Article 23(m)-10(c). "The

lessor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed." We have previously stated the statutory objections to this. But receding from this position for this portion of the argument, we will asume such upward revision of basis proper.[30] Next, "and a corresponding amount must be returned as income." If the Commissioner can raise basis we can no longer object to this. If statutory depletion be held dependent upon actual ultimate extraction under the lease, the untaxed royalty of prior years will be treated as income, not return of capital. Next, "for the year in which such lease expires, terminates or is abandoned." We can and do object to this. None of the untaxed royalty here involved was received in 1937. Some of it was received in 1929, some in 1930, and so on to 1936. This untaxed royalty cannot possibly be income for 1937. The Commissioner cannot by regulation make 1937 income out of 1936 or 1929 income. The facts speak for themselves. And the facts of this case show that the Commissioner by regulation is attempting to cumulate amounts of income allocable to each of a series of eight prior years and to superimpose that accumulation on the taxpayer's real income for 1937.

The unreasonableness of this procedure lies not alone in the fact that these untaxed royalties are classified as income. The unreasonableness lies principally in classifying them as 1937 income. The totally unjustified penalty resulting is the consequence of the utter distortion of the taxpayer's 1937 income. The accumulation of many years' income is suddenly dumped into one year by an artificial device purport-

[30]Only the 1937 income is in issue in this case. If the Commissioner can raise capital account, such revision means that prior royalty receipts were income instead of capital. But the conclusion does not follow that because such revision is made in 1937 that the prior royalty receipts become income for 1937. If the Commissioner can raise capital account the conclusion follows that he should re-assess the tax for each of the prior years and this he could do by appropriate regulation.

edly designed to get back from the taxpayer the benefit derived from use of the deduction. This artificially inflates the taxpayer's gross income for the year from $53,260.11 to $106,559.14. By applying surtax rates applicable in the $50,000 to $100,000 brackets, the regulation recovers for the Government not only the $6,923.51 which the taxpayer saved by deducting a permissible amount, but it strikes her with an additional penalty of nearly $20,000. Why a penalty? By what authority? There is nothing specific in the statute authorizing this. The only alleged justification for Article 23(m)-10(e) which we have seen or heard of is that the taxpayer derived a tax benefit from a depletion deduction and no depletion occurred; therefore he should square up. Assuming the absence of statutory impediment, we could not object to a regulation which in practice squared accounts. But we complain of a regulation which first squares up and then adds a tremendous penalty for which there is neither equitable nor statutory justification.

We have shown how the regulation operates in practical application. We have shown that a costly penalty is imposed. We have claimed that the imposition of this penalty is contrary to statute and thus the regulation is void. We proceed to demonstrate why the regulation is void under the law.

The law of our case is very simple. It rests on the single principle that cumulation of the income of many years is improper. Certainly the taxpayer cannot cumulate his deductions for ten years and deduct the accumulated total in the eleventh year.[31]

There can be no sincere doubt that our income tax law is based fundamentally on the principle of dividing the taxpayer's income into annual periods. Surtax rates are fixed

[31] *Burnet vs. Sanford & Brooks Co.* (1931), 282 U. S. 359, 75 L. Ed. 383, 51 S. Ct. 150. *Burnet vs. Thompson Oil & Gas Co.* (1931), 283 U. S. 301, 306, 75 L. Ed. 1049, 1053, 51 S. Ct. 418.

with the taxpayer's *annual* income in mind. The surtax percentage on $106,559.14 income is obviously intended to hit an annual income of $106,559.14, and obviously not intended to hit a cumulative total of income received in each of many years. Any regulation which destroys the basic concept of a tax based on annual income is necessarily violative of the statute.

Because of this basic concept it becomes important to measure the taxpayer's annual income. The annual income of a cash basis taxpayer is measured by the amount received within the year. *Sections 41 and 42:* When determining the taxability of the receipt of a given $100, it is not enough to answer the question, "Is it income?" Our income tax law is so basically designed to tax income in annual units that it is necessary to answer the further question, "For what year is it income?"

Our case, in this portion of our brief, therefore revolves around the second question only. To-wit, "For what year is the $53,299.03 added to Bessie P. Douglas' gross income taxable?" Even granting that that sum is income, our position is that none of it is 1937 income. The method used by the Commissioner classifies that amount as income for the year 1937. We submit that at this point the Commissioner and his regulation again fall into error. The Commissioner answers the first question by determining that the untaxed royalties were income. If that issue be determined against us, he is yet in error. His error, so far as this portion of the regulation is concerned, consists in determining that those untaxed royalties were income for the year 1937.

We assert that Article 23(m)-10(e) violates specifically the provisions of Section 41, Section 42 and Section 23(m). We shall take these up separately.

2. Article 23(m)-10(c) is in conflict with Sections 41 and 42, Revenue Act of 1936, because (1) it requires income received in one year to be included in the income of a later year in which it was not received, and (2) it cumulates income received in each of a series of years and taxes it as if received in one year.

The material portion of Section 41 is as follows: "The net income shall be computed on the basis of the taxpayer's *annual* accounting period * * *." This is the fundamental concept of our statute. It is a tax on *annual* income. *Burnet vs. Sanford & Brooks Company* (1931), 282 U. S. 359, 75 L. Ed. 383, 51 S. Ct. 150, holds that our income tax is basically founded upon annual determination of income. This being true, it becomes essential to determine the year to which a given item of income belongs.

This is determined by Section 42, the material portion of which provides that "the amount of all items of gross income shall be included in the gross income *for the taxable year in which received by the taxpayer*, * * *."[32] The year for inclusion in gross income is the year of receipt.

From the foregoing, the conclusion is clear that Article 23(m)-10(c) violates the letter and spirit of the statute. The conflict is obvious. The regulation attempts to nullify Section 41 by lumping the income of many years. Section 41 says that such income must not be lumped but must be divided into annual portions. The regulation attempts to nullify Section 42 by putting an item of gross income received in 1929 into the gross income of 1937. And items received in 1930, 1931, 1932, 1933, 1934, 1935 and 1936 into the gross income of 1937. Section 42 says these items must be included in the gross income of the year in which received

[32]Italics ours. The portion of Section 42 omitted from the above quotation permits departure from the strict rule only where departure is necessary clearly to reflect income. See Section 41.

by the taxpayer. Pursuant thereto, they were once so included (R. 37, par. B.6; R. 46). *None* of these items were received in 1937. The regulation is a fictional and artificial device which gathers up the income received in each of a series of years and assigns it to the gross income of a single year. And the cumulation of income thus effected is clearly violative of the fundamental fabric of the law.

Let us follow the effect of cumulation of income a little deeper into the statute. The effect of the violation of Sections 41 and 42 becomes alarming when Section 12 comes into play. Section 12 contains the graduated surtax rates and imposes the tax on "surtax net income." "Surtax net income" is defined as the net income in excess of certain credits. Net income is elsewhere defined as gross income less certain deductions. Accordingly, anything which distorts a taxpayer's gross income will distort his surtax net income. The graduated scale of surtax rates makes obvious the vice of fictionally inflating gross income for any year.

And when the income of many years is ascribed to the gross income of a single year the cumulative penal effect is vastly magnified. Witness the effect of cumulating the untaxed royalties received by Bessie P. Douglas in each of eight separate years and superimposing the aggregate upon her real gross income for the year 1937. The impact of $100,000 surtax rates on a $50,000 taxpayer results in an indefensible penalty. Under the current rates (1942 Act), this would be devastating. Nothing is more clear to us than that Congress had no such eventuality as this in mind in enacting the surtax rates which the Commissioner has applied to the inflated 1937 income of Bessie P. Douglas.

3. Article 23(m)-10(c) is in conflict with Section 23(m), Revenue Act of 1936, because its inherent penal nature in effect denies the statutory "reasonable allowance for depletion."

Let us pass on to an examination of the conflict between Article 23(m)-10(c) and Section 23(m) of the statute. Section 23(m) is the specific section of the statute which Article 23(m)-10(c) is designed to interpret. It provides:

> "* * * a reasonable allowance for depletion * * *, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, * * *."

Yes, the Commissioner is authorized to make regulations governing depletion. But the net effect of his regulations must be to grant a *reasonable* allowance for depletion. A regulation inherently involving an unjustifiable penalty has no place in this framework.

The allowance of depletion against *advance royalties* (*i. e.*, before extraction of ore) is permitted by the statute. In *Herring vs. Commissioner*,[33] the Commissioner attempted to deny the taxpayer's right to deduct depletion against advance royalties (bonus) but this Court held against him.

Now, what happens when a mining lease is terminated and no ore has been extracted? What, if anything, must we do with the taxpayer who has enjoyed the benefits (and suffered the burdens) of a depletion deduction granted to him upon the assumption that he would suffer exhaustion of his mine? Squaring accounts either through reduced depletion in the future, or if that be not the statutory intent, through recomputation of tax for prior years, appears reasonable to us. Squaring accounts is the only theory upon which Ar-

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[33] *Herring vs. Commissioner of Internal Revenue* (1935), 293 U. S. 322, 79 L. Ed. 389, 55 S. Ct. 179.

ticle 23(m)-10(c) has been supported so far. But the facts of the Bessie P. Douglas case explode any such attempted justification for Article 23(m)-10(c). The total additional tax she would have paid from 1929 to 1936 had she never deducted depletion would have been $6,923.51. The tax due to inserting $53,299.03 in the income of 1937 is $26,550.65. Is this recoupment? Does Article 23(m)-10(c) accomplish its pretended purpose of squaring accounts? By providing the allowance, Congress could not have intended, that when a mining lease terminates, taxpayer should be worse off than if no allowance had been granted.

The imposition of such a penalty is the practical denial of the "reasonable allowance" prescribed by statute. This allowance is not the Commissioner's to give and it is not his to take away. The Commissioner ostensibly obeys the mandate of Congress by allowing depletion against advance royalties. But he renders the allowance unreasonable by packing Article 23(m)-10(c) with such potential dynamite as to render the deduction the source of grave harm to the taxpayer instead of making it the source of benefit to the taxpayer which Congress intended. For this reason we assert that Article 23(m)-10(c) is void because it nullifies the attempt of Congress to provide "a reasonable allowance for depletion" against advance royalties.

We believe we have fully exposed the practical operation of the regulation and the hardships resulting from its inherently unsound principle of cumulation of income. The Board and the Circuit Court recognized the hardship (R. 49, 80). It remains to dispose of the alleged justifications advanced by the Government, the Board, and the Circuit Court of Appeals to support the validity of the regulation and its penal operation.

The Board considered itself reversed by the reference to Article 23(m)-10(c) in the *Murphy Oil Company* case,

though the *Herring* case stated the question was undecided. See *Grace M. Barnett*, 39 B. T. A. 864. At most, the reference in the *Murphy Oil Company* case involved *adjustment of capital account.*[33a] Even assuming it proper to raise the basis, the question of the proper disposition of the corresponding amount of income was not even apparently involved. None of the parties there before the Court was interested in what happens when a mining lease terminates. Almost without discussion of the merits of this case, the Board felt foreclosed by the authority of the *Murphy Oil Company, Sneed, Crabb,* and *Lamont* cases (R. 49).

The Board thereupon introduced the principle of geographic, not intrinsic uniformity, to dispose of our contention that the regulation was unjust and unreasonably harsh (R. 49-50). That principle relates to questions of constitutionality of a law. *Bromley vs. McCaughn*, 280 U. S. 124, 74 L. Ed. 226. We think it has nothing to do with this case. Where an administrative officer is authorized and directed by statute to make such regulations as will provide taxpayers "a reasonable allowance for depletion," we deem it of the very essence of the case and not even open to argument that such regulation must be *reasonable*. We have shown the amount of the penalty imposed on Mrs. Douglas, not for the purpose of showing discrimination against her, nor because the precise dollars-and-cents amount is significant. We have shown that penalty as a perfect illustration of the practical operation of the regulation against taxpayers generally and against her in this case. We consider it a clear exposition of the evils involved in the cumulation of income items received over many years and taxing them on the fictional assumption that they are the income of a single year. In the average case, the penalty will result from the application of *the principle of cumulation of many years' incomes*

[33a] Pp. 304, 306 of 287 U. S.; pp. 323, 324 of 77 L. Ed.

which is inherent in the regulation. It is no answer to this to say that in some other cases and on some other facts no penalty will result. No doubt even under this regulation, some taxpayers, so fortunate as to have a large loss in the year of lease termination, will escape the tax consequences of this descent of non-negotiable "income" upon their heads.[34]

The Circuit Court held erroneous our contention that income of prior years was being used to inflate our income of 1937 (R. 79-80). Its supporting statements are unrealistic. Depletion, says the Court, is "regarded as a reduction, or loss, of capital." The statutory allowance for depletion is a deduction allowed for the purpose of permitting recovery of capital investment out of income from the property. "The status of the depletion deduction then [upon termination of lease], and not until then, changes from capital loss to income both on the books of the lessor-taxpayer and for tax purposes" (R. 71).[35] Even were we to concede that there exists some process by which the "status" of an item can change from capital to income, such a theoretical meta-

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[34]Cf. *Langdon-Warren Mines, Inc., vs. Reynolds* (D. C., Minn., 1943), 52 F. Supp. (Adv. Sheet No. 6) 512; 43-2 U. S. T. C., Par. 9534. Here the taxpayer-lessor abandoned the mine when the lease was thrown up and thus avoided tax by offsetting the loss on abandonment against the accumulated "income" prescribed by Article 23(m)-10(c). We regard this case, not as a demonstration of the validity of Article 23(m)-10(c) as suggested by the Board (R. 49-50) and by the Circuit Court (R. 80-81). On the contrary, it is factual demonstration of its capricious results.

Had the lessor retained its mine, and offset the regulation-created income with an outside unrelated loss, the following would have been the peculiar result. No tax would have been due in the year of termination. Tax benefit would have been obtained in previous years from deductions of the apparent return of capital. Yet the regulation would lift the basis to its original level and thus help the taxpayer on its merry way in again deducting the same depletion under some future lease, or in recovering the same capital upon some future sale, or in recovering the same capital out of abandonment in some future year of large income. It is almost unbelievable that the same regulationecould produce such widely varying results in cases of three taxpayers so similarly situated and yet be held reasonable and related to truth instead of the pure fiction which it is.

[35]Cf. "(It) was income when they received it, and is income now." *Lamont vs. Commissioner*, 120 F. (2d) 996.

Also: "Adjustment may have to be made by reporting a balancing item in income for the year in which the change occurs." *Grace M. Barnett* (1939), 39 B. T. A. 864.

morphosis cannot change the fundamental and actual facts as to the time when the item was received. The statute states, and this Court, in *Burnet vs. Sanford & Brooks Co.* (1931), 282 U. S. 359, 75 L. Ed. 383, 51 S. Ct. 150, held, that the *year of receipt* is the controlling factor and not the year in which an alleged change in "status" occurs.

By violating the fundamental rule as to time of receipt, by bunching items received in each of a series of years, the Board and the Circuit Court departed grossly from the principle laid down in the statute and in *Burnet vs. Sanford & Brooks Co., supra*, that income taxes are to be determined on the basis of the taxpayer's *annual* accounting period and on the basis of the net result of all transactions *within the year*. By permitting the cumulation of eight years' receipts the Board and the Circuit Court have sanctioned the imposition of surtax rates, designed only for annual incomes, against an unlawfully distorted net income containing the aggregate of incomes of many years.

Treating these royalty receipts as if they were held in an account or in a fund, in suspension for an indefinite future—a fund which by some process in 1937 changed from capital to income, and from income of prior years to income received in 1937, is fictional. Resort to fiction to sustain the unjust results of this regulation should not stand. In truth these amounts when received by taxpayer were subject only to her unfettered control and available for immediate enjoyment. We do not know where those funds were in 1937. She may have reinvested them in other ventures, she may have given them away, she may have used them for living expenses.

> "Bookkeeping entries do not produce either income or losses for the purposes of taxation. They are intended to record facts, and are evidential, but they do not create or destroy facts."
>
> *Northwestern States Portland Cement Co. vs. Huston*, 126 F. (2d) 196, 199.

Next the Circuit Court states that the deduction was allowed *on the condition* that the corresponding amount (untaxed royalty) be returned as income for the year of termination (R. 80). This begs the whole question in the case. It is of the very essence of this case to determine whether the Commissioner had authority to impose this condition and yet stay within the express mandate of the statute to give a "reasonable allowance for depletion," and the implied mandate not to violate other parts of the Revenue Act. The Circuit Court states at one point "The taxpayer is given an option to take or not to take a deduction for depletion" (R. 81). At another point, "This is the condition upon which the deduction is allowed" (R. 80).[36]

Let us have a look at that option and that condition. The deduction for depletion was proper when taken. *Murphy Oil Co. vs. Burnet*, 287 U. S. 299, 77 L. Ed. 318, 53 S. Ct. 161; *Herring vs. Commissioner*, 293 U. S. 322, 79 L. Ed. 389, 55 S. Ct. 179; Section 23(m), Revenue Act of 1936, and corresponding sections of prior Revenue Acts; Article 23(m)-10(b), Regulation 94, and corresponding provisions of prior regulations. Not only was it proper when taken, taxpayer had to take it when it was taken or forego it forever. She could not wait until actual mining began and take it contemporaneously and co-extensively with extraction of ore. That is what the *Murphy Oil Co.* attempted to do. But this Court sustained the Commissioner's contention that depletion must be taken, if at all, in the year when advance royalties are received. See also, *Herring vs. Commissioner, supra.* Even if she had decided to forego depletion rather than incur the grave risks of Article 23(m)-10(c), the statute itself would reduce her basis for depletion to the same extent as if she had taken it. *Section 113(b)(1)(B).*

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[36] "The deduction allowed for 1934 was proper but was granted conditionally. The petitioner by accepting the deduction also accepted the condition provided in the regulations." *Grace M. Barnett* (1939), 39 B. T. A. 864.

Thus, what is termed an "option" turns out to be no option at all.[37] Taxpayer could not choose to postpone the deduction to the time when actual extraction occurs. She could not even choose to forego the deduction completely without suffering the statutory depletion of her basis. Even if she refused forever the recovery of investment proffered by Section 23(m), she would be treated by Section 113(b)(1)(B) as having recovered her investment to the extent of the depletion "allowable." Thus, she is compelled to take her deduction in the year of advance payment.

To hold that, under the same statute giving the administrative officer a mandate to provide by regulation a "reasonable allowance for depletion," the Commissioner can make one regulation *requiring*[38] the taxpayer to deduct his depletion when advance payments are made and another subjecting him, if he does so, to this yearly accretion to a swelling reservoir of potential future tax liability, is to defeat the statute.

To hold that a statute which, in one part, confers a beneficial deduction on the taxpayer, and, in another part, reduces his recoverable investment to the extent that deduction is allowable whether taken or not, also intends to impose these disastrous future tax consequences upon him simply because he takes it and subsequent events show both him and the Commissioner to have been wrong, is equally to defeat the statute.

To force the taxpayer by regulation to gamble on the future, and by statute to reduce his basis if he chooses not to gamble, where, the obvious intent of Congress was that he should take a deduction, is to our minds most unreasonable. We are confident that Congress intended no such squeeze

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[37] "It may be described as the injustice of illusory opportunity." *Maguire & Zimet, Hobson's Choice in Federal Taxation*, 48 Harvard Law Review 1281.

[38] *Herring vs. Commissioner*, 293 U. S. 322, 79 L. Ed. 389, 55 S. Ct. 179. *Murphy Oil Co. vs. Burnet*, 287 U. S. 299, 77 L. Ed. 318, 53 S. Ct. 161. Art. 23(m)-10(b), Reg. 94.

to be applied to the taxpayer. Thus, we say that the taxpayer had no real option and that the Commissioner clearly exceeded his statutory authority in imposing this condition upon the exercise of the statute-granted right of deducting depletion. Even if there were no other violations of statute involved, this condition was an unreasonable one and consequently not authorized by Section 23(m). In addition, this condition involved the violations of other statutory provisions previously discussed.

This rule that the deduction must be taken, if at all, in the year in which the advance royalty is received, combined with the annual statutory reduction of basis, effectively blocks all justification for Article 23(m)-10(c) based upon the grounds of estoppel or implied consent of the taxpayer derived from the taking of the deduction. If there be any estoppel, it is against the Commissioner who *required* the deduction to be taken in advance of extraction.

Suppose Mrs. Douglas had not taken any depletion from 1929 to 1936. Her basis would nevertheless have been reduced by the annual operation of Section 113(b)(1)(B) to the extent of $53,299.03. Nor would there be anything in Article 23(m)-10(c) authorizing an upward adjustment of basis when the lease terminated because there would have been no "depletion deductions made in prior years." To say, as the Circuit Court said, that she had an "option to take or not to take" the deduction is surely stretching the meaning of the word option.

We believe we are right if we insist that the authority delegated to the Commissioner under Section 23(m) is not without limitation, and that at least his regulations must provide "a reasonable allowance for depletion," and must not conflict with other parts of the statute. To condition an allowance which had to be taken, if at all, when taken, which causes a reduction of basis whether taken or not, upon

the restoration of a corresponding amount in conjunction with other corresponding amounts to the income of some unknowable future year, is to make the original allowance unreasonable. To condition by regulation the statutory allowance for recovery of investment in such a way as to make it more desirable to forego such recovery is, in effect, to deny the reasonable allowance intended by Congress, to tax the recovery of capital, and thus defeat the statutory aim.

Next, the Circuit Court held depletion analogous to a liability reserve, citing *Maryland Casualty Company vs. United States*, 251 U. S. 342. The analogy is not good. To begin with, the insurance company was on an accrual basis. Part of the gross premiums received by it was required by law to be set aside into a specific fund to be held by it for the reason that liabilities for unearned premiums had accrued. Special statutory provision was required to make this deductible because in the absence of statute a liability indeterminate in amount is not "accrued." Thus, for purposes of the Revenue Act this liability had accrued. Then in a year when the liability ceases, income is held to have been received. But *the income* which is taxed is not the money received in the prior year. *Cessation of liability* in the subsequent year causes a gain in assets available for dividends which is *the income* which is taxed and it is taxed in the year in which received. *U. S. vs. Kirby Lumber Co.* (1931), 284 U. S. 1, 76 L. Ed. 131, 52 S. Ct. 4; *Helvering vs. American Chicle Company* (1933), 291 U. S. 426, 78 L. Ed. 891, 54 S. Ct. 460; Article 22(a)-14, Regulations 94. Cf. *Helvering vs. American Dental Co.* (1943), ... U. S. ..., 87 L. Ed. (Adv. Sheet No. 10) 574, ... S. Ct. ....

In accounting principles and practice there is a clear distinction between a depletion or depreciation "reserve" and a liability "reserve." This is not just a technical distinction but a very real one and based upon a material distinction

in the facts. The depletion reserve is technically known as a "Valuation Reserve" and is merely a device to show the reduction in capital investment. On any modern corporate balance sheet it will show as a deduction from the investment account to show at a glance the original cost (basis) of the asset, the deduction for depletion (depletion reserve), and the net remaining investment (adjusted basis). In no way does it represent assets held in a fund subject to any liability. There is no liability. On the other hand, liability "reserves" are nothing more or less than accrued liabilities.[39] To call "depletion reserve" an asset which becomes "released for general use," when in fact it is a measure of the reduction of original cost, is based upon a misconception of the facts. It is neither good law nor good accounting. The Treasury Regulations recognize the nature of "depletion reserves" in providing that taxpayer may deduct depletion directly from the investment account thus showing only the net cost (adjusted basis) or he may keep his original capital account (basis) intact and credit depletion to a "Depletion Reserve" which if deducted at any time from original cost (basis) will reflect at any time the remaining recoverable investment (adjusted basis). Article 23(m)-11, Regulations 94. The two are the same.

In our case, upon receipt of advance royalties no liability existed. Taxpayers were free to dispose of them as they then pleased and as such they constituted income, if at all, only in those years. Determination, in 1937, that those royalties were not in fact capital when received may retroactively

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[39]For discussions of this distinction between valuation reserves and liability reserves see:

(a) R. H. Montgomery, *Auditing Theory and Practice*, Sixth Edition, Ronald Press, 1940, p. 242.

(b) Kester, *Advanced Accounting*, Third Revised Edition, Ronald Press, 1933, p. 571.

(c) Gilman, *Analyzing Financial Statements*, Revised Edition, Ronald Press, 1934, pp. 234-237.

(d) Finney, *Principles of Accounting*, Prentice Hall, Inc., 1937, Vol. 1, Intermediate, p. 379.

change their character into income but it cannot change or destroy the facts that, if income, it was received all in years prior to 1937 (R. 37) and must be taxed, if at all, for the years in which received. Extinguishment in 1937 of "Reserve for Depletion" extinguishes only the "offset" against the invested capital account. It does not "release" any assets for general use. Superficial analogies cannot save the regulation from the charges that it is (1) unreasonable thus violating Section 23(m) and (2) repugnant to other provisions of statute.

The Circuit Court then stated, "The same rule applies to deductions for depreciation" (R. 80). This simply is not true. Even excessive and improper deductions for depreciation are deducted from taxpayer's basis. And, upon discovery, in some subsequent year, of the fact they were excessive, the basis remains reduced and the depleted basis is spread over the future life of the property. See the example in Treasury Regulations 94, Article 23(l)-5. Cf. *Virginian Hotel Corporation vs. Commissioner* (1943), 319 U. S. 523, 87 L. Ed. 1149, 63 S. Ct. 1260. This is precisely the treatment we are contending for in the preceding part of this brief. This is the treatment we believe is provided for by the statutory provisions relating to depletion. The estoppel applied against taxpayers who take excessive depreciation deductions is an estoppel preventing an increase in basis for subsequent taxable years. There is no statutory authority for reversing this procedure with respect to depletion.

The bad debt recovery cases have been advanced as authorities against our contention that income must be taxed to a cash basis taxpayer for the year in which received. Where a deduction for bad debts is made from gross income and results in a reduction of tax, all are now agreed that if payment of the debt is received in a subsequent year it is taxable in the year in which received. The statement of the case

carries the obvious distinction. The money taxed as income is received in the year for which it is taxed. The issue in such case is whether or not the events of prior years justify treating the cash recovery as income rather than capital in the year in which received. The Commissioner's contention in our case is not that we received cash or cash equivalent in 1937, but that the events of 1937 developed a change in the status of cash received in prior years, and that change of status not only justifies treating the prior receipts as income but justifies "transferring" them to 1937 and treating them as if received in 1937 while admitting they were not (R. 79-80).

Lamont vs. Commissioner (C. C. A.—8th), 120 F. (2d) 996, 998.

Sneed vs. Commissioner (C. C. A.—5th), 119 F. (2d) 767.

To treat payment of a previously deducted bad debt as capital would permit a double escape from tax with respect to the same item.

Cf. *Charles Ilfeld Co. vs. Hernandez* (1934), 292 U. S. 62, 68, 78 L. Ed. 1127, 1131, 54 S. Ct. 596.

Griffiths vs. Helvering (1939), 308 U. S. 355, 84 L. Ed. 319, 60 S. Ct. 277.

In our case, no double deduction can occur. *Section 113(b)(1)(B). Article 23(m)-11, Regulations 94.* In fact, by requiring the inclusion of these untaxed royalties in 1937 gross income, the Commissioner compels a double inclusion in gross income—a case unique in our experience of income tax law and one which must require the clearest sort of statutory authority to sustain it. The estoppel, if any, works against the Commissioner who required the deduction to be taken against advance payments.

"If there was any misleading, it was done by the Commis-

sioner * * *." *U. S. vs. Scott & Sons, Inc.* (C. C. A. 1st—1934), 69 F. (2d) 728, 732. "There would be just as much ground for the taxpayer to claim that the Government is estopped to change its position." *Sugar Creek Coal & Mining Co.* (1934), 31 B. T. A. 344.

The bad debt recovery cases, in turn, bring up the entire issue of the so-called "tax-benefit theory" as applied to this case. In addition to recoveries of bad debts, there are cases of recoveries of taxes previously paid, recoveries of insurance for previously deducted losses, recoveries of purchase price on rescission of stock sales, and other similar recoveries. These recoveries are in the nature of replacement of capital or reimbursement of expenses. In the absence of tax benefit or offset of gross income in prior years, even though ineffective deductions were claimed, such recoveries are treated as what they in fact are, and not as taxable income. *Dobson vs. Commissioner* (Dec. 20, 1943), ... U. S. ..., 88 L. Ed. (Adv. Sheet No. 4) 179, 64 S. Ct. 239. Cf. Section 116, Revenue Act of 1942, 56 Stat. 798, 812, C. 619, 26 U. S. C. A., 1942 Supp., Sec. 22 (now, Sec. 22(b)(12), I. R. C., relating to bad debt recoveries, tax refunds, and "delinquency amounts.") If, however, by the deduction in the previous years, the taxpayer has offset gross income he has recouped, out of income and without tax, sums sufficient to replace such capital or expense items. *Dobson vs. Commissioner* (relating to taxpayer Harwick, No. 47), *supra*, at page 189 of 88 L. Ed. If in the later year the taxpayer recovers the payment of a debt, or insurance for a loss, or a refund of taxes paid, or a return of purchase price of stock previously charged off against taxable income as a capital loss, it would not be right to permit him to consider such cash recovery as return of capital or as reimbursement of former expense because he has previously recouped a similar sum out of income by his prior deduction. Hence, a kind of

estoppel is applied against him, preventing him from claiming or treating such cash recoveries as return of capital or reimbursement of expense, which in reality they are, and requiring him to treat such cash recovery as taxable income, instead, in the year in which recovered. This is a rule which has been developed by the Courts in the absence of any specific statute governing the case. Tax benefit or offset of gross income in prior years estops him from treating as recovery of capital sums received in the later year, which amounts are treated in the later year as replacements of the income of the prior year which escaped tax by allocation to capital.[40]

The only point of similarity between our case and those cases is that we obtained tax benefit and offset of gross income by deducting depletion in prior years. But, we did not receive $53,299.03 in the taxable year 1937. The tax benefit theory is now urged against us to create an estoppel preventing us from claiming that sums received in annual installments from 1929 to 1936, allocated to capital in those years, do not assume the "status" of income for 1937. The fundamental distinction between our case and the tax benefit cases is that we did not receive the sum which is taxed as income in the year for which the tax is asserted. Our case is directly covered by statute, which was not true in those cases. The estoppel, provided by statute as we contend, or even independently of statute, derived from our tax benefit of earlier years is an estoppel preventing us from increasing our basis by the amount of the sums recovered in prior years, which we then thought were capital. It is an estoppel pre-

[40]This distinction between deductions which effect a recoupment out of income even though no tax saving results therefrom, and deductions which neither offset gross income nor produce tax saving, is set forth by the Board in our case at R. 52. Congress and the Treasury, however, dropped the distinction between "tax benefit" and "offset of gross income" as developed by the Board of Tax Appeals, when it enacted Section 22 (b) (12), I. R. C., relating to bad debt recoveries, tax refunds, and "delinquency amounts." Sec. 29.22(b)(12)-1 (b) (2), Regulations 111.

venting us in 1937 from using our undepleted basis for future like recoveries. Cf. *Virginian Hotel Corporation vs. Commissioner* (1943), 319 U. S. 523, 87 L. Ed. 1149, 63 S. Ct. 1260, where, had the excessive depreciation of prior years resulted in tax benefit, this Court, taxpayer, and Commissioner would have been in accord. Cf. also, *Murphy Oil Co. vs. Burnet* (1932), 287 U. S. 299, 77 L. Ed. 318, 53 S. Ct. 161.

Thus, we believe that the tax benefit theory has no proper application to our case because the statute, in Sections 114(b)(1) and 113(b)(1)(B), provides what is to happen to us because of the benefits derived from our deductions. And even if the statute did not so provide, the tax benefit theory should only result in keeping our basis reduced and not in cumulating amounts received in prior years and imposing the tax thereon as if such amounts were all income for some one later year. Further, even if basis can be raised and even if the prior receipts take off their capital "disguise," the tax benefit theory applied consistently with the other tax benefit cases should result only in taxing them in the respective years in which received.

It is only where the tax benefit theory is carried to the extreme result claimed by the Commissioner in this case, that is, it is only when Article 23(m)-10(c) is held valid, that we are forced to turn around and accept the Commissioner's claim at its face value and assert that Article 23(m)-10(c) is therefore invalid as applied to deductions which produced no tax benefit in prior years.

We have been met by the argument that deductions are matters of grace and therefore we cannot complain of the injustice attached to this deduction. This ignores the fact that deductions are matters of *legislative* grace and not blessings bestowed upon taxpayers by the Commissioner. Congress did not attach an unreasonable condition to the "reasonable allowance for depletion." This likewise ignores the

fact that this case directly involves only an item of alleged gross income. Retroactive disallowance of the deduction, if the statute be construed to permit it, can do nothing more than increase the taxable net income for each prior year. It cannot increase gross income for any year.

In summation, it is our position that even assuming statutory authority to wipe out past depletion deductions, it is repugnant to statute for the Commissioner to treat the cumulated income of prior years as if all received in one year. Such treatment destroys the annuality of the concepts of gross and net income thus creating a gross distortion of income and thus violating Sections 41 and 42, Revenue Act of 1936. It results in the indefensible application under Section 12(a) of surtax rates in the high brackets never intended to be applied to such "income." It imposes a penalty on taxpayer leaving her in a worse position than if she had never heard of the deduction for depletion, which cannot be what Congress intended by a "reasonable allowance." A regulation more radically repugnant to statute or more unreasonable in result could hardly be devised.[41] The Circuit Court erred as a matter of law in sustaining it.

IV. Assuming This Court Should Hold the Regulation Valid, It Should Not Be Applied to Deductions Taken When the Regulation Was Not in Effect.

When petitioners took their deductions in 1929, the regulation had been revoked by the Commissioner's published acquiescence in the Board decisions of *Knapp* (1927), 7 B. T. A. 790, and *Cooper* (1927), 7 B. T. A. 798. See acquiescenses at VII-1 C. B. 17, and VII-1 C. B. 1, respectively.[42]

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[41]Cf. "There could be a no more necessary or a more reasonable regulation prescribed. * * *" *Lamont vs. Commissioner*, 120 F. (2d) 996, 998. Two more reasonable regulations have been hereinbefore suggested; we believe the statute provides the most reasonable solution of all.

[42]For effect of acquiescence, see for example, XIII-2 C.B., p. iv.

Stronger or plainer language could not be chosen than—

> "How excessive deductions allowed in prior years can, upon the happening of a specified event in a subsequent year become income, is beyond our comprehension."
> *Knapp*, 7 B. T. A. 790, 792.

When the instant taxpayers took their deductions in 1929, 1930 and 1931 they were assured by the Board and by the highest authority in the Bureau of Internal Revenue that they would not be subjected to future liability therefor. The regulation was reprinted as Article 236 of Regulations 74 (1928 Act) which remained in effect until after the Commissioner withdrew acquiescence in 1932, but was disregarded in official Treasury practice.

When, in 1932, the Commissioner withdrew acquiescence in the *Knapp* and *Cooper* cases,[43] thus announcing that the regulation was again in effect, he could not lawfully give retroactive effect to it. To do so under a statute commanding a "reasonable allowance for depletion" would be the clearest inequity and the clearest volation of that statute.

> Compare, "We are asked to make a retroactive holding that for some seven years past a multitude of transactions have been taxable although there was no source of law from which the most cautious taxpayer could have learned of the liability. If he consulted the decisions of this Court, he learned that no such tax could be imposed; if he read the Delphic language of the Act in connection with existing decisions, it, too, assured him there was no intent to tax; if he followed the congressional proceedings and debates, his understanding of nontaxability would be confirmed; if he asked the tax collector himself, he was bound by the Regulations of the Treasury to advise that no such liability existed. It would be a pity if taxpayers could not rely on this concurrent assurance from all three branches of the

[43] Even after the withdrawal of acquiescence in 1932, these taxpayers had the assurance of the Board of Tax Appeals that their deductions would be held final. The Board did not reverse itself until 1939. *Grace M. Barnett*, 39 B. T. A. 864.

Government. But we are asked to brush all this aside and simply to decree that these transactions are taxable anyway."

Helvering vs. Griffiths (1943), ... U. S. ...., 87 L. Ed. (Adv. Sheet No. 10) 597, 615, ... S. Ct. ....

We are of the opinion that this regulation can not lawfully be applied to any deduction for depletion here involved taken prior to the date of withdrawal of acquiescence in the *Knapp* and *Cooper* decisions. (July-December, 1932, XI-2 C. B. 14 and 12.)

V. Depletion Deductions Resulting in No Tax Reduction When Taken Should Not Be Included in Gross Income in the Year of Termination of Lease.

In 1933 Bessie P. Douglas had a net loss of $8,989.46 without benefit of the deduction for depletion ($4,958.05) which she wrote on her return (R. 41-42). The Commissioner, while justifying Article 23(m)-10(c) on the theory that tax saving in prior years necessitated *recoupment*,[44] nevertheless, insisted upon the addition of that amount to 1937 income. The Board held the regulation invalid as applied to such a deduction (R. 56-57). The Circuit Court reversed the Board on the authority of its own recent decision in *Dobson vs. Commissioner* (Sub. nom. *Harwick vs. Commissioner*), 133 F. (2d) 732 (R. 87, 93), on the ground that the Board's decision was not in accordance with law. The Circuit Court held that it injected "into the law of deductions an equitable consideration contrary to the strict construction required to be placed upon statutes allowing deductions" (R. 93). We think Congress injected this principle of equity and fairness when it used the word "reasonable"

[44] "Ordinarily, the government may recoup only by restoring the deduction to income and asserting the tax against the taxpayer in the year of termination of the lease." G. C. M. 14448, XIV-1 C.B. 98.

in Section 23(m). The Board to that extent was clearly right. The Circuit Court's decision, upon which it relied to reverse the Board in our case, was reversed by this Court in *Dobson vs. Commissioner* (Dec. 20, 1943), ... U. S. ..., 88 L. Ed. (Adv. Sheet No. 4) 179, 64 S. Ct. 239.

If the meaningless writing on a prior income tax return did not estop the taxpayer, Dobson, from sustaining the claim that a large sum of cash actually received within the taxable year was not taxable income, it cannot estop the taxpayer, Douglas, from asserting that capital recovered in a previous year did not turn to taxable income in the taxable year when nothing was received. *Dobson vs. Commissioner* (Dec. 20, 1943), ... U. S. ..., 88 L. Ed. (Adv. Sheet No. 4) 179, 64 S. Ct. 239.

A similar situation exists with respect to a similar deduction taken by Bessie P. Douglas in 1934. In that year, after deducting depletion she had a net income of $3,160.10. She could, under the 1934 Revenue Act, have had $4,000 net income without either normal or surtax.[45] Thus to the extent of $839.90 her depletion deduction produced no tax benefit. There being no tax saving resulting from that $839.90, this amount should be treated identically with the 1933 deduction.[46] The Board, however, drew a somewhat tenuous distinction between the case where other deductions offset gross income and this case where it takes other deductions to partially offset gross income plus "credits" to offset the net income. This distinction was based upon the concept that replacement of *capital* out of "taxable income" in prior years,

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[45]Surtax commenced only after net income reached $4,000. Sec. 12(b), Revenue Act of 1934. Dividends received credit plus earned income credit ($5,894.05 plus $300 (R 41-42)) would have permitted net income to increase up to $6,194.05 without normal tax.

[46]Had the attention of Congress been drawn to deductions for depletion, when it enacted Section 22 (b) (12), I. R. C., this item of $839.90 would have constituted a "recovery exclusion" according to Reg. 111, Section 29.22(b)(12)-1(b)(2), being that portion of the deduction which could be disallowed without causing an increase in tax for 1934.

even though no tax reduction resulted, prevented a second recovery of capital without tax in the subsequent year (R. 52). This reasoning is not applicable in our case where there is only the recovery of the prior year—no funds, capital or income, were recovered in 1937. The closing remarks of this Court in the *Dobson* case (relating to taxpayer Harwick, No. 47) likewise apply to cases involving a second recovery in the subsequent taxable year. In our case there is no second recovery. In our case the statute gives more than an "inkling" of what should be done.[47] *Section 23(m).*

The 1932 deduction of Estate of Charles H. Robinson, No. 132, involves facts like the 1934 deduction of Mrs. Douglas. The estate was entitled to a personal exemption of $1,000 against a net income of $620.87 after deducting depletion (R. 39). Thus, to the extent of $379.13, the depletion deduction effected no reduction in tax. It should be treated identically with the 1933 and 1934 deductions of Bessie P. Douglas.

Where the only alleged justification for the validity of a regulation is the recoupment of tax benefits of prior years, to hold it applicable to the 1933 deduction of Bessie P. Douglas, as the Circuit Court did, is inconceivable. To distinguish between the 1933 deduction on the one hand and the 1934 and 1932 deductions on the other, as the Board did, is to deal in refinements beyond the point of reason.

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[47] "The statute gives no inkling of the correctness or incorrectness of the Tax Court's view, and we can find no compelling reason to substitute our judgment." *Dobson vs. Commissioner* (Dec. 20, 1943), ... U. S. ..., 88 L. Ed. (Adv. Sheet No. 4) 179, 64 S. Ct. 239.

VI. The Regulation Was Not Validated by Enactment of the Revenue Acts.

As previously pointed out Article 23(m)-10(c), Regulations 94, or its counterpart has been in all regulations issued since Regulations 45 promulgated in April, 1919, under the 1918 Revenue Act and continues currently as Section 29.23(m)-10(c) of Regulations 111 issued under the Internal Revenue Code as amended. For some unexplained reason it was reprinted as Article 236 of Regulations 74 (1928 Act) although disregarded in official Treasury practice by reason of the Commissioner's acquiescence in the *Knapp* and *Cooper* cases.

At no time prior to 1939 was there a decision of any judicial body sustaining validity of Article 23(m)-10(c). From 1927 to 1939, the Board of Tax Appeals' position was that it was invalid. From 1927 to 1932, the official Treasury position was that it was invalid. We are at a loss to understand how reenactment of the Revenue Act served as Congressional approval of this relatively obscure provision of the regulations. The enactment of the Revenue Act of 1928, just as much and even more logically, gave Congressional approval of the Board's decisions of 1927 and the Commissioner's acquiescence therein.

An invalid regulation is a mere nullity. If the regulation is unreasonable or lacks statutory authorization, the subsequent reenactment of the statute does not make law out of the regulation. The regulation is of no force or effect.

> "'The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress—but the power to adopt regulations to carry into effect the will of Congress as expressed by the statute. A regulation which does not do this, but operates to create a rule

out of harmony with the statute, is a mere nullity. *Lynch vs. Tilden Produce Co.*, 265 U. S. 315, 320-322, 68 L. Ed. 1034-1036, 44 S. Ct. 488; *Miller vs. United States*, 294 U. S. 435, 439, 440, 79 L. Ed. 977, 980, 981, 55 S. Ct. 440, and cases cited. And not only must a regulation, in order to be valid, be consistent with the statute, but must be reasonable. *International R. Co. vs. Davidson*, 257 U. S. 506, 514, 66 L. Ed. 341, 346, 42 L. Ed. 179. The original regulation as applied to a situation like that under review is both inconsistent with the statute and unreasonable."

Manhattan General Equipment Co. vs. Commissioner (1936), 297 U. S. 129, 134, 80 L. Ed. 538, 56 S. Ct. 397.

In the case of *F. W. Woolworth Co. vs. United States* (C. C. A. 2nd—1937), 91 F. (2d) 973, the Court stated:

"The reasoning by which such rulings are deemed to be incorporated into the law upon its reenactment are familiar, and we should have no right to disregard it, whether or not in a given instance it represents a real assent by Congress. But not every ruling is incorporated in the text because it is not repudiated; no one has ever suggested anything of the sort. At most, administrative practice is a weight in the scale, to be considered, but not to be inevitably followed. Here the inference is a good deal weaker than usual because it rests upon an interpretation applicable to the British act which is but a part of all the section covers. To suppose that Congress must particularly correct each mistaken construction under penalty of incorporating it into the fabric of the statute appears to us unwarranted; our fiscal legislation is detailed and specific enough already. While we are of course bound to weigh seriously such rulings, they are never conclusive; here, it seems to us that they are not enough to turn the scale."

Numerous other decisions have announced the rule and its limitations but no opinion has more forcefully exposed the faulty reasoning behind it than that in the case of *Helver-*

ing vs. Hallock (1940), ... U. S. ..., 84 L. Ed. 383.[48] The *Hallock* case overruled the eight-year-old *St. Louis Trust Co.* case. Between these two cases the Revenue Act was reenacted and amended a number of times. The argument was advanced that, in view of the reenactment of the law, Congress had approved the construction placed upon the statute by the *St. Louis Trust Co.* case and that construction must now be considered as the true meaning of the statute. In refutation of this argument this Court said:

> "Nor does want of specific Congressional repudiations of the *St. Louis Trust* case serve as an implied instruction by Congress to us not to reconsider, in the light of new experience, whether those decisions, in conjunction with the *Klein* case, make for dissonance of doctrine. It would require very persuasive circumstances enveloping Congressional silence to debar this Court from reexamining its own doctrines. To explain the cause of non-action by Congress when Congress itself sheds no light is to venture into speculative unrealities. Congress may not have had its attention directed to an undesirable decision; and there is no indication that as to the *St. Louis Trust* cases it had, even by any bill that found its way into a committee pigeon-hole. Congress may not have had its attention so directed for any number of reasons that may have moved the Treasury to stay its hand. But certainly such inaction by the Treasury can hardly operate as a controlling administrative practice, through acquiescence, tantamount to an estoppel barring reexamination by this court of distinctions which it had drawn. Various considerations of parliamentary tactics and strategy might be suggested as reasons for the inaction of the Treasury and of Congress, but they would only be sufficient to indicate that we walk on quicksand when we try to find in the absence of corrective legislation a controlling legal principle."

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[48]See also: Erwin N. Griswold, *A Summary of the Regulations Problem*, 54 Harvard Law Review 398. Robert C. Brown, *Regulations, Reenactment, and the Revenue Act*, 54 Harvard Law Review 377. A. H. Feller, *Addendum to the Regulations Problem*, 54 Harvard Law Review 1311. Erwin N. Griswold, *Postscriptum*, 54 Harvard Law Review 1323.

If the reenactment of the Revenue Act without change does not incorporate into the statute the construction placed upon it by decision of the highest judicial authority of the land, after that construction has been subjected to the searchlight of litigation, it is hard to conceive of any reason why the interpretation of the Commissioner of Internal Revenue should by the same process be placed beyond the realm of judicial scrutiny. If the Supreme Court is not barred by intervening reenactment from examining its own decisions on construction, how can it be barred from examining the decisions of the Commissioner? All of the arguments in the *Hallock* case apply with redoubled force where a mere regulation is involved.

Nor does the age of this regulation entitle it to greater dignity or respect. Taxpayers generally have not worsened their positions by reliance upon its validity as, for example, they had in the non-taxable stock dividend cases. *Helvering vs. Griffiths* (1943), ... U. S. ..., 87 L. Ed. (Adv. Sheet No. 10) 597, 615, ... S. Ct. .... If the regulation be held valid many will worsen their positions by declining the "benefits" of the "reasonable" allowance for depletion against advance payments. A decision declaring the regulation invalid will lift an oppressive burden from taxpayers who, for many years past, have been recipients of bonuses or advance royalties and who are faced with this explosive and unpredictable liability should the contingency some future day occur. Yet, such a decision will leave them to bear the burden in an orderly fashion in years subsequent to lease termination. Such a decision will relieve the already dominant mining company lessees of their most effective weapon for beating down a fair royalty rate by threat of cancellation when a sufficient back log of "chameleonic capital" has been built up over the lessor-taxpayer's head.

VII. The Circuit Court Had Full Jurisdiction to Reverse the Board and Should Have Done so on the Ground That the Board's Decision Was Contrary to Law.

We have left the question of jurisdiction to the last because we feel that a full exposition of the case shows that the decision of the Board was based upon, not one, but several clear errors of law.

At no time have the facts been in dispute. The facts were either alleged and admitted in the pleadings or resolved by stipulations of fact (R. 36-43). The Board of Tax Appeals specifically adopted the stipulations as its findings of fact (R. 45). It found the facts as we view them and as we have stated them herein.

Our contention in the Board, as in the Circuit Court and here, was and is that there is no authority in the Revenue Act for promulgation of this regulation and that the regulation as promulgated is in conflict with the statute. On petitions for review to the Circuit Court we assigned certain conclusions of law drawn by the Board from the agreed facts as errors of law (Petition for Review, pars. III and IV, R. 57). We think the case involves pure questions of law and in consequence thereof the Circuit Court had full jurisdiction to reverse the decision of the Board of Tax Appeals. *Dobson vs. Commissioner* (Dec. 20, 1943), ... U. S. ..., 88 L. Ed. (Adv. Sheet No. 4) 179, 64 S. Ct. 239.

It is our contention that the applicable statutes forbid the method of calculation of the deficiencies determined by the Board of Tax Appeals. As such, the Board's conclusions of law drawn from the agreed facts and the decision entered pursuant thereto was not "in accordance with law" and the Circuit Court was empowered to reverse it. Revenue Act 1926, Sec. 1003(b), 44 Stat. 9, 110, C. 27, now I. R. C., Sec. 1141(c)(1), 26 U. S. C. A., 1940 Ed., Sec. 1141(c)(1).

We further believe that we have demonstrated that Article 23(m)-10(c) of Regulations 94, was wholly unauthorized by the Revenue Act, in conflict therewith, and wholly unreasonable in practical operation and result. Both the Board of Tax Appeals and the Circuit Court of Appeals clearly erred as a matter of law in sustaining it.[49]

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[49]We are aware of the fact that usually a decision of the Board is entitled to weight but in this case it is clear that the Board's judgment was not wholly unfettered by the thought that this Court had approved the regulation in *Murphy Oil Co. vs. Burnet* (1932), 287 U. S. 299, 77 L. Ed. 318, 53 S. Ct. 161 (R. 49).

See also the same reasoning in *Grace M. Barnett* (1939), 39 B. T. A. 864, which is the fountainhead and practically sole precedent for the subsequent Board cases including the instant ones. Less weight is ordinarily attached to a decision of the Board where its judgment is patently not entirely independent. *Commissioner vs. Heininger* (Dec. 20, 1943), ... U. S. ..., 88 L. Ed. (Adv. Sheet No. 4) 197, 64 S. Ct. 249.

FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 130
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Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE.

No. 131
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No. 132
ESTATE OF CHARLES H. ROBINSON, NORTHWESTERN NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, JESSIE P. ROBINSON, ET AL., ETC.,
Petitioners,
vs.
COMMISSIONER OF INTERNAL REVENUE.

No. 133
BERNICE B. DALRYMPLE,
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COMMISSIONER OF INTERNAL REVENUE.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

PETITIONERS' REPLY BRIEF

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CASE CITED

Page

Virginian Hotel Corporation vs. Commissioner (1943), 319 U. S. 523, 87 L. Ed. 1149, 1154, 63 S. Ct. 1260 5

STATUTES AND REGULATIONS CITED

Statutes:

Revenue Act of 1936, C. 690, 49 Stat. 1648:

Section 23(m) 2, 6

Section 113(b)(1)(B) 2, 3, 4, 6

Section 114(b)(1) 2

Treasury Regulations:

Regulations 94:

Article 23(m)-10(e) 3

REPORTS OF CONGRESSIONAL COMMITTEES

Report, Ways and Means Committee (1932 Revenue Act) (72nd Congress, 1st Session, H. Rept. 708, page 22) 4

Report, Senate Finance Committee (1932 Revenue Act) (72nd Congress, 1st Session, S. Rept. 665, page 29) 4

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PETITIONERS' REPLY BRIEF

The law is settled that the aggregate $53,299.03 received by Mrs. Douglas in annual amounts from 1929 to 1936 was allocated by the Revenue Act, through the combined operations of Sections 23(m), 114(b)(1) and 113(b)(1)(B), to return of capital investment when received. The only issue in the case, if the plain language of the statute be adhered to, is "Was that return of capital conditional or was it permament?" And, if the plain language of the statute be applied, the answer is that the return of capital was permanent. *Section 113(b)(1)(B).* There ends the Commissioner's case.

Not enough emphasis can be placed upon Section 113(b)(1)(B) as specifically stating the mature and considered judgment of Congress as to the *statutory effects* on the taxpayer of having taken the depletion deduction granted by Section 23(m). Reflection upon the words of Section 113(b)(1)(B), which provide that basis shall *in all cases* be reduced by depletion "to the extent *allowed* (but not less than the amount *allowable*) under this Act or prior income tax laws," shows that Congress considered and passed upon the very issue involved in this case. The words used cover all possible cases:

1. Where taxpayer deducts exactly the right amount of depletion.

2. Where taxpayer deducts too little depletion.

3. Where taxpayer deducts depletion deemed excessive.

Where taxpayer deducts exactly the right amount of depletion the statutory terms "allowed" and "allowable" mean the same thing and his basis is reduced to the extent of his deduction.

Where taxpayer deducts too little depletion, his basis is reduced by more than his deduction—*i. e.,* to the extent "allowable."

Where the taxpayer deducts depletion deemed excessive his basis is reduced by the amount of the deduction "allowed" *even though it is subsequently found that he has deducted too much.*

This statute provides very clearly that after depletion has been allowed, and if the statute of limitations bars the Commissioner from disallowing the deduction, and if information is subsequently obtained showing the allowance to have been excessive, the remedy is not adjustment by restoring capital account and by taxing a "corresponding amount" as income. The *statutory* remedy is to continue to treat past recovery as capital and prevent a second recovery of that capital by keeping basis reduced to the extent of prior depletion allowed. Article 23(m)-10(c) insists upon doing exactly what the statute states shall not be done.

The language of Section 113(b)(1)(B) is explicit. No further interpretative data is needed. Yet, when we turn to the committee reports relating to this section they are even more specific in condemning the theory on which Article 23(m)-10(c) is based.

The Report of the Ways and Means Committee of the House with reference to Section 113(b)(1)(B) of the Revenue Act of 1932 contains the following:

> "In subparagraph (B), relating to depreciation, etc., for the period since February 28, 1913, the bill requires that adjustment be made 'to the extent allowed (but not less than the amount allowable)' instead of 'by the amount * * * allowable' as in the prior act. The Treasury has frequently encountered cases where a taxpayer, who has taken and been allowed depreciation at a certain rate consistently over a period of years, *later finds it to his advantage to claim that the allowances so made to him were excessive* and that the amounts which

were in fact 'allowable' *were much less. By this time the Government may be barred from collecting the additional taxes which would be due for the prior years* upon the strength of the taxpayer's present contentions. The Treasury is obliged to rely very largely upon the good faith and judgment of the taxpayer in the determination of the allowances for depreciation, since these are primarily matters of judgment and are governed by facts particularly within the knowledge of the taxpayer, and the Treasury should not be penalized for having approved the taxpayer's deductions. While the committee does not regard the existing law as countenancing any such inequitable results, it believes the new bill should specifically preclude any such possibility."

Report, Ways and Means Committee (1932 Revenue Act) (72nd Congress, 1st Session, H. Rept. 708, page 22).*

The Report of the Senate Finance Committee with respect to this section contains the above quoted matter and, in addition thereto, it contains the following illuminating statement.

"Your committee has not thought it necessary to include any *express provision against retroactive adjustments of depreciation* on the part of the Treasury as the regulations of the Treasury seem adequate to *protect the interests of taxpayers* in such cases. These regulations require the depreciation allowances to be made from year to year in accordance with the then known facts and *do not permit a retroactive change in these allowances by reason of the facts developed or ascertained after the years for which such allowances are made.*"

Report, Senate Finance Committee (1932 Revenue Act) (72nd Congress, 1st Session, S. Rept. 665, page 29).*

In the face of the background of Section 113(b)(1)(B), how can the Commissioner assume to have authority to make retroactive adjustments to the basis for depletion? Where

*Italics added.

Congress states that it wishes to protect taxpayers from such adjustments, that no express provision is deemed necessary, that the statute of limitations bars recomputation of tax for such prior years, why can the Commissioner deem himself authorized to do a far worse and more injurious thing to the taxpaper, *i. e.,* reclassify capital into income, add it back to the base, and then, not recompute tax for prior years, but, instead, throw the whole burden into the teeth of the surtax rates for one year's income?

Depletion, at best, is only a guess. Even with respect to actual royalty on ore mined and shipped the amount of the allowance is never accurate. No one can know the number of tons of ore in the ground. Estimates vary. Unsuspected faults in ore veins show up upon mining. Measurements can only be partial. New information may at any time show previous estimates to have been greatly off. Hence, at no time does the amount allowed agree with the amount of actual extraction. Nor, in view of the underlying purpose of the allowance for depletion, is it important that depletion at all times goose step with production. What is important is that the allowance be so spread over the gross income during the life of the property that the taxpayer be reasonably assured of a return of his investment and that he cannot recover by way of depletion more than the amount of that investment.

> "What is important for the protection of the revenues is that accrual for depreciation be applied only to property that is properly depreciable, that it be stopped when the property is fully depreciated, and that the rate be consistently applied so that the taxpayer cannot choose to take only a little depreciation when he has a little income and a lot of depreciation when he has a large income."
>
> *Virginian Hotel Corporation vs. Commissioner* (1943), 319 U. S. 523, 87 L. Ed. 1149, 1154, 63 S. Ct. 1260.

To hold these sums to be income, to have been only an illusory kind of capital, the Commissioner must fly in the face of Section 113(b)(1)(B), of the Committee reports, of the specific prohibition contained in the second sentence of Section 23(m) applicable to a case identical in principle with this case, of the underlying purpose of the allowance for depletion, and, perhaps worst of all, in the face of common sense and justice. And all of this he must do without a single statutory word to sustain him.

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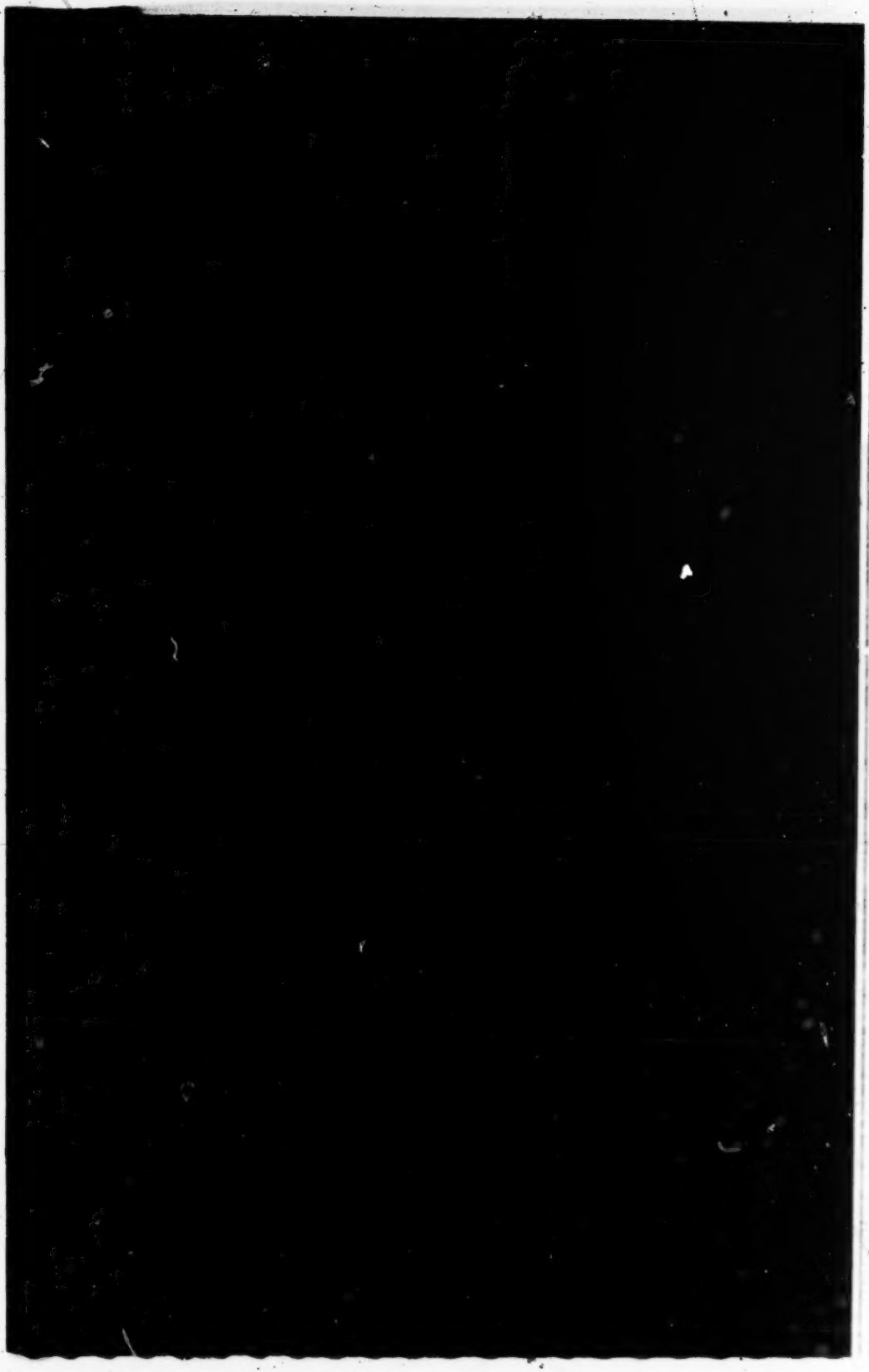

INDEX

	Page
Opinions below	2
Jurisdiction	2
Questions presented	2
Statutes and regulations involved	3
Statement	3
Argument	5
Conclusion	9
Appendix	10

CITATIONS

Cases:	
Burnet v. *Sanford & Brooks Co.*, 282 U. S. 359	7
Commissioner v. *Dallas Title & Guar. Co.*, 119 F. 2d 211	7
Crabb v. *Commissioner*, 119 F. 2d 772, remanded for rehearing, 121 F. 2d 1015	6
Doyle v. *Commissioner*, 110 F. 2d 157, certiorari denied, 311 U. S. 658	7
Harwick v. *Commissioner*, 133 F. 2d 732, certiorari granted June 14, 1943, *sub nom. Dobson* v. *Helvering*, Nos. 44–47 this Term	8
Helvering v. *Bruun*, 309 U. S. 461	7
Helvering v. *State-Planters Bank & Trust Co.*, 130 F. 2d 44	8
Helvering v. *Virginian Hotel Corporation*, 132 F. 2d 909, affirmed, June 7, 1943, No. 766, October Term, 1942	8
Lamont v. *Commissioner*, 120 F. 2d 996	6
Maryland Casualty Co. v. *United States*, 251 U. S. 342	7
Murphy Oil Co. v. *Burnet*, 287 U. S. 299	6, 7
Sneed v. *Commissioner*, 119 F. 2d 767, rehearing denied, 121 F. 2d 725, certiorari denied, *sub nom. Thompson* v. *Commissioner*, 314 U. S. 686	6
Virginia Iron Coal & C. Co. v. *Commissioner*, 99 F. 2d 919, certiorari denied, 307 U. S. 630	7
Statutes:	
Revenue Act of 1936, c. 690, 49 Stat. 1648:	
Sec. 23	5, 10
Sec. 113	10
Sec. 114	11
Revenue Act of 1938, c. 289, 52 Stat. 447, Sec. 23	6

Miscellaneous:

Treasury Regulations 45, Art. 215 6
Treasury Regulations 62, Art. 215 6
Treasury Regulations, 65 Art. 216 6
Treasury Regulations 69, Art. 216 6
Treasury Regulations 74, Art. 236 6
Treasury Regulations 77, Art. 230 6
Treasury Regulations 86, Art. 23 (m)-10 6
Treasury Regulations 94:
Art. 23 (m)-10 ..... 5, 6, 7, 12
Art. 23 (m)-11 13
Treasury Regulations 101, Art. 23 (m)-10 6
Treasury Regulations 103, Sec. 19.23 (m)-10 6

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ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 47–57) is reported at 46 B. T. A. 943. The opinion of the Circuit Court of Appeals (R. 86–94) is reported at 134 F. 2d 762.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered on April 7, 1943 (R. 94–96). The petition for writs of certiorari was filed July 1, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether an amount equalling the total deductions taken by the taxpayers, as lessors, for depletion on advance royalties in the years when such royalties were received should be included in gross income in a later year when the mining lease was terminated without any production having occurred under the lease.

2. Whether (in the case of Bessie P. Douglas) the amount deducted as depletion in 1933, when a net loss was sustained, should be excluded from gross income in the year of the termination of the lease because no tax benefit was received from the deduction in 1933.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations involved are set forth in the Appendix, *infra*, pp. 10–13.

STATEMENT

The Board of Tax Appeals adopted as its findings of fact (R. 47–57) the stipulated facts (R. 39–47). The pertinent facts may be summarized as follows:

Prior to 1929 Bessie P. Douglas, Adeline R. Morse, Charles H. Robinson and Irene B. Robinson Cirkler owned an iron ore mine situated in St. Louis County, Minnesota, known as the "Pettit" mine. Bessie P. Douglas owned an undivided one-half interest in the mine and each of the others an undivided one-sixth interest therein. (R. 40.)

In 1929 the owners leased the mine for a term of thirty years commencing July 1, 1929. The lease provided that minimum royalties should be paid annually whether any ore was extracted during the year or not. Such royalties were to be applied on ore later mined and shipped. The lease also provided for its cancellation by the lessee and in 1937, pursuant to such provision, the lessee canceled the lease without having removed any ore from the mine during the existence of the lease. (R. 50.)

From the execution of the lease until its termination, the lessee paid the agreed advance royalties

to the lessors or their respective successors. The lessors or successors, in filing their income tax returns, which were prepared on the cash basis, reported in their gross incomes for the respective years the royalties received in such years and took deductions for depletion with respect to such royalties. The deductions thus taken were computed on the cost basis and were allowed by the Commissioner. (R. 50.) The amounts of royalties and depletion taken are set forth in tables at R. 41, 43, and 45.

In determining the deficiencies herein the Commissioner, under the provisions of Article 23 (m)-10 of Treasury Regulations 94, treated as gross income for 1937 the aggregate of the depletion deductions claimed by, and allowed to, the taxpayers for the years prior to and including 1936, with respect to the minimum royalties received by them from the lease on the Pettit mine. The amounts so included in gross income were: Estate of Charles H. Robinson, $9,829.14; Bessie P. Douglas, $53,299.03; Adeline R. Morse, $18,180.26; Irene B. Robinson Cirkler, $18,180.26. (R. 50.)

In the year 1933, the taxpayer Bessie P. Douglas had a net loss of $13,947.51. In that year she took a depletion deduction with respect to the advanced royalties in the amount of $4,958.05. (R. 41.)

The Board held (1) that the regulations on which the Commission relied are valid and (2) that all of the depletion deductions taken in prior

years were properly included by the Commissioner as taxable income except as to $4,958.05 in the case of Bessie P. Douglas (R. 51–57). As to that amount, the Board held she had received no tax benefit.

Accordingly, the Board found deficiencies in income tax for 1937 against Bessie P. Douglas in the amount of $26,977.56 (R. 57); against the estate of Charles H. Robinson in the amount of $1,532.38 (R. 58); and against Bernice B. Dalrymple, as transferee of the assets of Irene B. Robinson Cirkler, deceased, in the amount of $5,412.47 (R. 58–59).

The Circuit Court of Appeals affirmed the Board's decision on the first issue but reversed the Board on the second issue (involving only Mrs. Douglas) and held on that issue that she must include the sum of $4,958.05 in income for the taxable year.

ARGUMENT

1. Section 23 (m) of the Revenue Act of 1936 (Appendix, *infra*, p. 10), provides for a reasonable allowance for depletion under rules and regulations to be prescribed by the Commissioner. Article 23 (m)–10 of Regulations 94, promulgated thereunder (Appendix, *infra*, p. 12), provides that when a mining lease expires or is abandoned before the mineral which has been paid for in advance is extracted, the taxpayer shall adjust his capital account by restoring thereto the depletion

deductions made on account of royalties on mineral paid for but not removed and a corresponding amount must be returned as income for the year the lease is terminated. The decision of the court below, holding that the regulation is a reasonable and valid regulation, is in accord with previous decisions. *Sneed* v. *Commissioner*, 119 F. 2d 767 (C. C. A. 5th), rehearing denied, 121 F. 2d 725, certiorari denied *sub nom. Thompson* v. *Helvering*, 314 U. S. 686; *Lamont* v. *Commissioner*, 120 F. 2d 996 (C. C. A. 8th). See also *Crabb* v. *Commissioner*, 119 F. 2d 772 (C. C. A. 5th), remanded to the Board for a rehearing on a different ground, 121 F. 2d 1015. The validity of the regulation is reinforced by the fact that a like provision has appeared in all of the regulations relating to the income tax since 1919, and in each instance has been issued pursuant to a statutory provision similar to that referred to in Section 23 (m), *supra*. Cf. *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299, 302.[1]

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[1] The regulation first appeared in Regulations 45, Article 215, and was issued pursuant to Section 214 (a) of the Revenue Act of 1918 and appeared thereafter in Regulations 62, Article 213, issued under Section 214 (a) of the Revenue Act of 1921; Regulations 65 and 69, Article 216, issued under Section 214 (a) of the Revenue Acts of 1924 and 1926; Regulations 74, Article 236, issued under Section 23 (l) of the Revenue Act of 1928; Regulations 77, Article 230, issued under Section 23 (l) of the Revenue Act of 1932; Regulations 86, 94 and 101, Article 23 (m)-10, issued under Section 23 (m) of the Revenue Acts of 1934, 1936 and 1938, and Regulations 103, Section 19.23 (m)-10, issued under Section 23 (m) of the Internal Revenue Code.

The decision of the court below is not inconsistent with *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, holding that the Revenue Acts have uniformly assessed income tax on the basis of annual returns showing the net result of the taxpayer's transactions during the year. In the earlier years when the minimum royalties were received, depletion was allowed in anticipation of production. *Murphy Oil Co.* v. *Burnet, supra;* Article 23 (m)-10 of Regulations 94. Until the lease was terminated, it could not be known that the ore paid for in advance would not be removed and it was reasonable to condition the allowance of the depletion in the earlier years on the restoration of the amounts to income if the lease should be terminated without the removal of the ore. This result is a consequence of, and not inconsistent with the annual structure of the income tax. Cf. *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, 352; *Doyle* v. *Commissioner,* 110 F. 2d 157 (C. C. A. 2d), certiorari denied, 311 U. S. 658; *Virginia Iron Coal & C. Co.* v. *Commissioner,* 99 F. 2d 919 (C. C. A. 4th), certiorari denied, 307 U. S. 630; *Commissioner* v. *Dallas Title & Guar. Co.,* 119 F. 2d 211 (C. C. A. 5th). Also compare *Helvering* v. *Braun,* 309 U. S. 461.

The taxpayer argues that the regulation is contrary to Section 23 (m) which prohibits an adjustment of the basis for depletion. The sentence relied upon, however, merely provides that where

the estimate of recoverable units is discovered to be erroneous as a result of operations or development work, the estimate of recoverable units, but not the basis, shall be adjusted. It has no application to a case where a lease is terminated and the right to depletion ceases.

2. Assuming that the first issue has been correctly decided, a second one is presented in the case of Mrs. Douglas as to whether the amount of the depletion deduction taken by her in 1933, when she sustained a net loss, should be included in income in the taxable year. In repudiating the tax benefit theory and deciding this issue against the taxpayer, the court below relied on its own decision in *Harwick* v. *Commissioner,* 133 F. 2d 732 (C. C. A. 8th), now pending here on certiorari granted June 14, 1943,[2] on *Helvering* v. *State-Planters Bank & Trust Co.,* 130 F. 2d 44 (C. C. A. 4th), and on *Helvering* v. *Virginian Hotel Corporation,* 132 F. 2d 909 (C. C. A. 4th), affirmed by this Court on June 7, 1943, No. 766, 1942 Term. However, the pendency of the *Harwick* case in this Court does not require the granting of certiorari herein, for the decision below is in accord with Treasury regulations of long standing that are not involved in the *Harwick* case.

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[2] The *Harwick* case and companion cases are presently identified in this Court as *Dobson* v. *Helvering*, Nos. 44-47, 1943 Term.

CONCLUSION

The petition for writ of certiorari should be denied.

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JULY 1943.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. * * *

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

* * * * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. * * *

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for Depletion.*—

(1) *General Rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 23 (m)-10. *Depletion—Adjustments of accounts based on bonus* or advanced royalty. * * *

(b) If the owner has leased a mineral property for a term of years with a requirement in the lease that the lessee shall extract and pay for, annually, a specified number of tons, or other agreed units of measurement, of such mineral, or shall pay, annually, a specified sum of money which shall be applied in payment of the purchase price or royalty per unit of such mineral whenever the same shall thereafter be extracted and removed from the leased premises, an amount equal to that part of the basis for depletion allocable to the number of units so paid for in advance of extraction will constitute an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by the lessor shall be claimed or allowed in any subsequent year on account of the extraction or removal in such year of any mineral so paid for in advance and for which deduction has once been made.

(c) If for any reason any such mineral lease expires or terminates or is abandoned before the mineral which has been paid for in advance has been extracted and removed, the lessor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned.

* * * * *

ART. 23 (m)–11. *Depletion and depreciation accounts on books.*—Every taxpayer claiming and making a deduction for depletion and depreciation of mineral property shall keep accurate accounts in which shall be recorded the cost or other basis provided by section 113 (a), as the case may be, of the mineral deposit and of the plant and equipment, together with subsequent allowable capital additions to each account and all of the other adjustments required by section 113 (b).

If the plan or method of depletion and depreciation accounting adopted by the taxpayer has once been approved by the Commissioner, it can not be changed by the taxpayer without the consent of the Commissioner. These accounts shall thereafter be credited annually with the amounts of the depletion and depreciation computed in accordance with articles 23 (m)–2, 23 (m)–3, 23 (m)–4, or 23 (m)–5; or the amounts of the depletion and depreciation so computed shall be credited to depletion and depreciation reserve accounts, to the end that when the sum of the credits for depletion and depreciation equals the cost or other basis of the property, plus subsequent allowable capital additions, no further deductions for depletion and depreciation with respect to the property shall be allowed, except such depletion deductions as may thereafter be allowable under section 114 (b) (2), (3), or (4) and articles 23 (m)–3, 23 (m)–4, or 23 (m)–5.

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U. S. GOVERNMENT PRINTING OFFICE: 1943

INDEX

	Page
Opinion below	1
Jurisdiction	1
Questions presented	1
Statutes and Regulations involved	3
Statement	3
Summary of argument	6
Argument:	
I. Article 23 (m)–10 (e) of Regulations 94, requiring that amounts equal to deductions for depletion on advance royalties under mining leases taken by the lessors in previous years be reported as gross income in 1937 when the leases were terminated without ore having been extracted, is valid	9
II. The regulation is valid without tax benefit qualification	32
Conclusion	39
Appendix A	40
Appendix B	46

CITATIONS

Cases:	
Anderson v. *Helvering*, 310 U. S. 404	17
Avent v. *United States*, 266 U. S. 127	10
Baird v. *United States*, 65 F. 2d 911, certiorari denied, 290 U. S. 690	30
Barnett v. *Commissioner*, 39 B. T. A. 864	12
Bourne v. *Commissioner*, 62 F. 2d 648, certiorari denied, 290 U. S. 650	30
Burnet v. *Sanford & Brooks Co.*, 282 U. S. 359	19, 30
Burnet v. *Thompson Oil & G. Co.*, 283 U. S. 301	10, 13, 17
Buttfield v. *Stranahan*, 192 U. S. 470	10
Commissioner v. *Dallas Title & Guar. Co.*, 119 F. 2d 211	30, 32
Cooper v. *Commissioner*, 7 B. T. A. 798	11
Crabb v. *Commissioner*, 119 F. 2d 772	22
Dobson v. *Commissioner*, decided December 20, 1943, rehearing denied, February 14, 1944	8, 28, 29, 34
Doyle v. *Commissioner*, 110 F. 2d 157, certiorari denied, 311 U. S. 658	30, 32, 36
Field v. *Clark*, 143 U. S. 649	10
Helvering v. *Bankline Oil Co.*, 303 U. S. 362	17
Helvering v. *Bruun*, 309 U. S. 461	30, 36
Helvering v. *Reynolds Co.*, 306 U. S. 110	13
Helvering v. *Wilshire Oil Co.*, 308 U. S. 90	13, 14, 15

Cases—Continued. Page

Helvering v. *Winmill*, 305 U. S. 79 13
Herring v. *Commissioner*, 293 U. S. 322 ..... 20, 21, 22
Houston Farms Development Co. v. *United States*, decided January 13, 1942, decided on another point, 131 F. 2d 577 ..... 12, 22
Knapp v. *Commissioner*, 7 B. T. A. 790 11
Lamont v. *Commissioner*, 120 F. 2d 996 12
Maryland Casualty Co. v. *United States*, 251 U. S. 342 .. 19, 30, 36
Murphy Oil Co. v. *Burnett*, 287 U. S. 299 ..... 7, 11, 12, 13, 20, 21, 22, 29
National Lead Co. v. *United States*, 252 U. S. 140 13
Security Flour Mills v. *Commissioner*, No. 276, decided February 28, 1944 35
Shawmut Co. v. *Commissioner*, 120 F. 2d 996 12
Sneed v. *Commissioner*, 119 F. 2d 767, rehearing denied, 121 F. 2d 725, certiorari denied, 314 U. S. 686 ..... 12, 22
Stanton v. *Baltic Mining Co.*, 240 U. S. 103 17
Stratton's Independence v. *Howbert*, 231 U. S. 399 17
Swayne & Hoyt, Ltd. v. *United States*, 300 U. S. 297 14
Titsworth v. *Commissioner*, 73 F. 2d 385 10
United States v. *Dakota-Montana Oil Co.*, 288 U. S. 459 18
United States v. *Grimaud*, 220 U. S. 506 10
United States v. *Ludey*, 274 U. S. 295 17
Von Baumbach v. *Sargent Land Co.*, 242 U. S. 503 17
Virginian Hotel Corp. v. *Helvering*, 319 U. S. 523 33
Virginia Iron Coal & C. Co. v. *Commissioner*, 99 F. 2d 919, certiorari denied, 307 U. S. 630 ..... 30, 32
Warren Service Corp. v. *Commissioner*, 110 F. 2d 723 30

Statutes:

Income Tax Act of 1913, c. 16, 38 Stat. 114, 166, Sec. II B. 17
Internal Revenue Code:
Sec. 23 (26 U. S. C., Sec. 23) 18
Revenue Act of 1916, c. 463, 39 Stat. 756, Sec. 5 ..... 11, 17
Revenue Act of 1918, c. 18, 40 Stat. 1057, Sec. 214 ..... 12, 17
Revenue Act of 1921, c. 136, 42 Stat. 227, Sec. 214 13
Revenue Act of 1924, c. 234, 43 Stat. 253, Sec. 214 13
Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 214 13
Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 23 13
Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 23 ..... 13, 23
Revenue Act of 1934, c. 277, 48 Stat. 680, Sec. 23 13
Revenue Act of 1936, c. 690, 49 Stat. 1648:
Sec. 22 30
Sec. 23 ..... 6, 7, 10, 13, 14, 18, 22, 23, 24, 26, 31, 40
Sec. 41 31
Sec. 42 31
Sec. 62 10
Sec. 113 ..... 7, 22, 26, 27, 28, 29, 41
Sec. 114 ..... 22, 26, 42
Sec. 275 31
Revenue Act of 1938, c. 289, 52 Stat. 447, Sec. 23 13

Miscellaneous: Page

Alvord, Treasury Regulations and the Wilshire Oil Case, 40 Colum. L. Rev. 252, 259 (1940) 10
Brown, Regulations, Reenactment, and the Revenue Acts, 54 Harv. L. Rev. 377 (1941) 14
75 Cong. Record, Part 7, p. 7233 25
XI-2 Cum. Bull. 12 12
Feller, Addendum to the Regulations Problem, 54 Harv. L. Rev. 1311, 1321 (1941) 14
G. C. M. 941, VI-1 Cum. Bull. 205 12
G. C. M. 14448, XIV-1 Cum. Bull. 98 (1935) 22, 46
Griswold, A Summary of the Regulations Problem, 54 Harv. L. Rev. 398 (1941) 10, 14
H. Conference Rep. No. 1037, 65th Cong., 3d Sess., p. 50 (1939-1 Cum. Bull. (Part 2) 130, 136) 16
H. Conference Rep. No. 1492, 72d Cong., 1st Sess., p. 11 (1939-1 Cum. Bull. (Part 2) 539, 540) 25
H. Rep. No. 767, 65th Cong., 2d Sess., p. 10 (1939-1 Cum. Bull. (Part 2), 86, 93) 16
H. Rep. No. 1, 69th Cong., 1st Sess., pp. 19-20 (1931-1 Cum. Bull. (Part 2) 315, 328-329) 35
Lee, Legislative & Interpretive Regulations, 29 Georgetown L. J. 1 (1940) 10
Paul, Studies in Federal Taxation (Third Series, 1940) 420 14
S. Rep. No. 617, 65th Cong., 3rd Sess., p. 8 (1939-1 Cum. Bull. (Part 2) 117, 122) 16
S. Rep. No. 665, 72d Cong., 1st Sess., p. 16 (1939-1 Cum. Bull. (Part 2) 496, 507-508) 23, 24
T. D. 3938, V-2 Cum. Bull. 117 (1926) 13
Treasury Regulations 45, Art. 215 11, 12, 13
Treasury Regulations 62, Art. 215 12
Treasury Regulations 65, Art. 216 13
Treasury Regulations 69, Art. 216 13
Treasury Regulations 74, Art. 236 13
Treasury Regulations 77:
Art. 230 13
Art. 236 11
Treasury Regulations 86, Art. 23 (m)-10 13
Treasury Regulations 94:
Art. 23 (m)-10 6, 7, 9, 10, 12, 13, 22, 27, 33, 36, 42
Art. 23 (m)-11 44
Treasury Regulations 101, Art. 23 (m)-10 13
Treasury Regulations 103, Sec. 19.23 (m)-10 13
Treasury Regulations 111, Sec. 29.23 (m)-10 13

In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 130

BESSIE P. DOUGLAS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 131

BESSIE P. DOUGLAS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 132

ESTATE OF CHARLES H. ROBINSON, NORTHWESTERN NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, JESSIE P. ROBINSON, ET AL., ETC., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

No. 133

BERNICE B. DALRYMPLE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the Board of Tax Appeals (R. 44–53) is reported at 46 B. T. A. 943. The opinion of the Circuit Court of Appeals (R. 75–82) is reported at 134 F. 2d 762.

JURISDICTION

Judgments of the Circuit Court of Appeals were entered on April 7, 1943 (R. 83–85). A petition for writs of certiorari was filed July 1, 1943, and granted on January 10, 1944 (R. 85–86). Jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the amounts equal to the total deductions taken by each of the taxpayers, as lessors, for depletion on advance royalties under mining leases in the years when such royalties were received, should be included in gross income in a later year when the leases were terminated without any ore having been mined.

2. Whether any part of such amounts should be excluded from income on the ground that no tax benefit was received in the year in which the deductions were taken.

STATUTES AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in Appendix A, *infra*, pages 40–45.

STATEMENT

The Board of Tax Appeals adopted as its findings of fact (R. 45–47), the stipulated facts (R. 36–43). They may be summarized as follows:

On July 1, 1929, Bessie P. Douglas, Adeline R. Morse, Charles H. Robinson, and Irene B. Robinson Cirkler owned an iron ore mine situated in St. Louis County, Minnesota, known as the "Pettit" mine. Bessie P. Douglas owned an undivided one-half interest in the mine and each of the others, an undivided one-sixth interest. Robinson, who died August 16, 1932, and Mrs. Cirkler, who died on October 20, 1937, still owned their interests in the property at the time of death. Robinson's estate is in process of administration, the Northwestern National Bank of Minneapolis, Jessie P. Robinson, and Charles J. Robinson being coexecutors. Mrs. Dalrymple is transferee of all of the assets of Mrs. Cirkler. (R. 17, 18, 19, 26, 27, 45, 46.)

In 1929 the four owners leased the mine to the Republic Steel Corporation for a term of thirty years beginning July 1, 1929. The lease provided that minimum royalties should be paid annually whether any ore was extracted during the

year or not. Such royalties were to be applied on ore later mined and shipped. The lease also provided for its cancellation by the lessee, and in 1937, pursuant to such provision, the Republic Steel Corporation cancelled the lease without having removed any ore from the mine during the existence of the lease. (R. 46.)

From the execution of the lease until termination, the lessee paid the agreed advance royalties to the lessors or their successors. The lessors or successors in filing their income tax returns, which were prepared on the cash basis, reported in their gross incomes for the respective years the royalties received and took deductions for depletion with respect to such royalties. The deductions thus taken were computed on a cost basis and allowed by the Commissioner. (R. 46.) The amounts of advance royalties reported in income and depletion taken by the taxpayers and allowed by the Commissioner, were as follows (R. 37–43):

Year	Douglas		Robinson		Cirkler	
	Royalties	Depletion	Royalties	Depletion	Royalties	Depletion
1929	$2,500.00	$1,239.51			$833.33	$413.19
1930	15,000.00	4,968.05			3,333.33	1,652.75
1931	10,000.00	4,968.05			3,333.33	1,652.75
1932	10,000.00	4,968.05	$833.33	$413.19	3,333.33	1,652.75
1933	10,000.00	4,968.05	3,333.32	1,176.00	3,333.33	1,652.75
1934	12,500.00	6,197.56	4,166.66	2,065.94	5,000.00	2,479.13
1935	22,500.00	11,155.61	7,500.00	2,646.01	7,500.00	3,718.69
1936	30,000.00	14,874.15	10,000.00	3,528.00	10,000.00	4,958.25

In determining the deficiencies, the Commissioner, pursuant to Article 23 (m)–10, Treasury Regulations 94, treated as gross income for 1937 the aggregate of the depletion deductions claimed by, and allowed to, the taxpayers for the years prior to and including 1936, with respect to the minimum royalties received by them for the lease on the Pettit mine (R. 46–47).

In 1933, Bessie P. Douglas had a net loss of $13,947.51. In that year she took a depletion deduction with respect to the advance royalties in the amount of $4,958.05. (R. 50.)

The Board held that the regulations on which the Commissioner relied are valid and that all the depletion deductions taken in prior years were properly included by the Commissioner as taxable income with the exception of $4,958.05 in the case of Bessie P. Douglas, because as to that amount she had received no tax benefit (R. 47–53). Accordingly, the Board found deficiencies in income taxes for 1937 against Bessie P. Douglas in the amount of $26,977.56 (R. 53); against the estate of Charles H. Robinson in the amount of $1,532.38 (R. 54); and against Bernice B. Dalrymple, as transferee of the estate of Irene B. Robinson Cirkler, deceased, in the amount of $5,412.47 (R. 54–55).

The Circuit Court of Appeals affirmed the Board's decision on the first issue but reversed the Board on the second issue involving only

Mrs. Douglas, and held that she must include also the sum of $4,958.05 in income for the taxable year (R. 81–82).

SUMMARY OF ARGUMENT

I

As petitioners concede, Article 23 (m)–10 (c) of Treasury Regulations 94 requires that amounts equal to the depletion deductions taken on minimum royalties received by them in prior years as lessees under their mining lease, be included in taxable income in the year when the lease was terminated without minerals having been extracted.

The regulation is valid. It was adopted under Section 23 (m) of the Revenue Act of 1936, which provides for a reasonable allowance for depletion under rules and regulations to be prescribed by the Commissioner. Thus it has the force of law by express delegation of Congress. Moreover, an identical provision has been in the regulations since 1919, during which time the statute has been reenacted nine times. The implication arising from reenactment that Congress has approved the regulation is particularly applicable where, as here, the statute expressly requires that a detailed scheme to effectuate its ends be established by administrative regulations. In consequence, the regulation is entitled to the utmost respect because it is the administrative solution, long ap-

proved by Congress, of the "highly technical and involved" depletion problem.

The reasonableness of the regulation is evidenced by the fact that the Tax Court and the Circuits Courts of Appeals for the Fifth and Eighth Circuits expressly, and this Court, in *Murphy Oil Co.* v. *Burnet,* 287 U. S. 299, by implication, have approved it. Under the regulation, a depletion deduction is allowed for the anticipated wasting of a capital asset conditioned on treating as income amounts equal to the deduction when it becomes known, as by the cancellation of a lease without extraction of ore, that the amounts are income and not a return of capital because there will be no diminution of capital. The reasonableness of this treatment is demonstrated by the similar result reached independently of a regulation in analogous situations.

The provision of Section 23 (m) requiring a revision of prior estimates of the number of recoverable units in light of information obtained by operations but prohibiting an adjustment of basis has no application to the situation here. This is confirmed by the reason for prohibiting an adjustment of basis in the statutory situation and the necessity of adjusting basis under the circumstances of this case as provided in the regulation as well as by the legislative history. Such adjustment is not contrary to Section 113 of the statute but is clearly within the authorization provided by Section 113 (b) (1) (A).

II

The Board, in concluding that an amount equal to the depletion deduction taken by Mrs. Douglas in 1933, which did not effect a tax saving, was not income in the year of cancellation of the lease, held contrary to the regulation. Since the regulation provides that an amount equal to "depletion deductions made in prior years" be returned as income, there is no basis for tax-benefit qualification.

Petitioners' reliance on *Dobson* v. *Commissioner*, Nos. 44–47, decided December 20, 1943, rehearing denied February 14, 1944, not yet reported, is unfounded, because in that case this Court did not adopt the tax-benefit theory but merely held that the Tax Court was free to do so in the absence of a controlling regulation. Every consideration advanced by this Court to give finality to the Tax Court in the situation presented by the *Dobson* case applies with equal force to the regulation here.

Since the justification for treating as income when the lease is cancelled amounts equal to depletion deductions formerly taken is that at that point its status as profit is first known, there is no reason for eliminating amounts from income equal to depletion deductions that did not effect a tax saving. Even without the regulation the Board's conclusion is without foundation because it treated the problem as if a loss recovery were.

involved. Such treatment completely fails to fit the facts of this case.

ARGUMENT

I

ARTICLE 23 (m)-10 (c) OF REGULATIONS 94, REQUIRING THAT AMOUNTS EQUAL TO DEDUCTIONS FOR DEPLETION ON ADVANCE ROYALTIES UNDER MINING LEASES TAKEN BY THE LESSORS IN PREVIOUS YEARS BE REPORTED AS GROSS INCOME IN 1937 WHEN THE LEASES WERE TERMINATED WITHOUT ORE HAVING BEEN EXTRACTED, IS VALID

1. The Commissioner determined, the Board of Tax Appeals and the Circuit Court of Appeals for the Eighth Circuit held and petitioners concede that the Treasury Regulations plainly require that amounts equal to the total deductions taken by them in previous years for depletion on advance royalties should be included in gross income in 1937 when the leases were terminated without the extraction of ore. Article 23 (m)-10 (c) of Treasury Regulations 94 (Appendix A, *infra*, p. 43), provides that—

> If for any reason any such mineral lease expires or terminates or is abandoned before the mineral which has been paid for in advance has been extracted and removed, the lessor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, *and a corresponding amount must be returned as income for the year in which*

the lease expires, terminates, or is abandoned. [Italics supplied.]

This regulation was promulgated under Section 23 (m) of the Revenue Act of 1936 (Appendix A, *infra*, p. 40) which provides for a reasonable allowance for depletion under rules and regulations to be prescribed by the Commissioner and is, threfore, a "legislative",[1] as opposed to an "interpretative", regulation.[2] See *Burnet* v. *Thompson Oil & G. Co.*, 283 U. S. 301, 305. As such the regulation has the same effect as if its language were contained in the statute[3] (*Avent* v. *United States*, 266 U. S. 127; *United States* v. *Grimaud*, 220 U. S. 506; *Titsworth* v. *Commissioner*, 73 F. 2d 385 (C. C. A. 3d)), subject only to the qualification that the Commissioner must not have exceeded the authority delegated.

That the Commissioner has stayed within his authority is strongly implied by the fact that in the 25 years of the existence of Article 23 (m)–

[1] Alvord, Treasury Regulations and the Wilshire Oil Case, 40 Colum. L. Rev. 252, 259 (1940); Griswold, A Summary of the Regulations Problem, 54 Harv. L. Rev. 398, 400 (1941); Lee, Legislative & Interpretive Regulations, 29 Georgetown L. J. 1 (1940).

[2] "Interpretative" regulations are authorized under Section 62 of the Revenue Act of 1936, which provides that—

"The Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this title."

[3] The constitutionality of delegation of legislative power of this nature has long been recognized. *Field* v. *Clark*, 143 U. S. 649; *Buttfield* v. *Stranahan*, 192 U. S. 470.

10 (c) or its counterpart in other Regulations,[4] its validity has been relatively infrequently challenged and has consistently been sustained by the courts and also by the Board of Tax Appeals.[5]

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[4] See footnote 6, *infra*.

[5] The early decisions of *Knapp* v. *Commissioner*, 7 B. T. A. 790 (Acq. VII–1 Cum. Bul. 17), and *Cooper* v. *Commissioner*, 7 B. T. A. 798 (Acq. VII–1 Cum. Bul. 7), relied on by petitioners (Br. 9–10) as contrary to these decisions, are distinguishable. The Board treated these cases as if all of the depletion for the years prior to the termination of the lease in 1919 had been taken under Section 5 (a) Eighth (b) of the Revenue Act of 1916, c. 463, 39 Stat. 756, authorizing a depletion deduction "not to exceed the market value in the mine of the product thereof, *which has been mined and sold during the year* for which the return and computation are made" (italics ours). Under this provision depletion could not be deducted in advance of production, whereas the underlying assumption of the regulation herein involved, first promulgated as Art. 215 of Regulations 45 (1919 Ed.), is that depletion is deductible in advance of production. The advance depletion allowed by the Commissioner was thus unlawfully deducted, whereas the regulation was intended to apply to depletion lawfully deducted but proved excessive by subsequent events. Under the statute involved the termination of the lease without production was consequently a wholly irrelevant circumstance, and the Board's conclusion that it could not be made the occasion for adding back to income an amount equal to the unlawful deductions could not be condemned. The Commissioner's acquiescence in these decisions (VII–1 Cum. Bul. 7, 17) thus cannot be taken as meaning, as petitioners urge, that he viewed the regulation as invalid under the Revenue Act of 1918 and subsequent acts under which advance depletion is properly deductible (*Murphy Oil Co.* v. *Burnet*, 287 U. S. 299). This conclusion is reinforced by the fact that in Regulations 77, Art. 236, he promulgated a regulation substantially identical to that involved in the *Knapp* and *Cooper* cases. The date of these regulations was February 15, 1929, about eighteen months after those deci-

Lamont v. *Commissioner* and *Shawmut Co.* v. *Commissioner* (decided contemporaneously), 120 F. 2d 996 (C. C. A. 8th); *Sneed* v. *Commissioner*, 119 F. 2d 767 (C. C. A. 5th), rehearing denied, 121 F. (2d) 725 (C. C. A. 5th), certiorari denied, 314 U. S. 686; *Barnett* v. *Commissioner*, 39 B. T. A. 864; *Houston Farms Development Co.* v. *United States* (S. D. Texas), decided January 13, 1942 (1942 C. C. H., par. 9374), decided on another point, 131 F. 2d 577 (C. C. A. 5th). Cf. *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299.

Congress, too, may be said to have approved the way in which the delegated authority has been exercised. A provision identical with Article 23 (m)–10 (c) of Regulations 94 has been in the regulations since 1919 when Regulations 45, Article 215, was adopted pursuant to Section 214 (a) of the Revenue Act of 1918 and has appeared in all income tax regulations thereafter issued. Yet Congress has reenacted the provision delegating authority to the Commissioner to provide a "reasonable allowance for depletion" in nine Revenue Acts without regard to the several Revenue Acts amending the Code.[4] Frequently this Court has

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sions and about twelve months after the Commissioner's acquiescence in them. This acquiescence was withdrawn in 1932 (XI–2 Cum. Bull. 12, 14). In G. C. M. 941, VI–1 Cum. Bull. 205 (1927) it is expressly stated that a precedent established by acquiescence in a Board decision is only binding where the facts in the two cases are identical.

[4] In addition to Regulations 45, Article 215, the provision appeared thereafter in Regulations 62, Article 215, issued

declared in situations involving "interpretative" regulations of long standing that they acquire the force of law through reenactment of the statute substantially unchanged (*Helvering* v. *Reynolds Co.*, 306 U. S. 110; *Helvering* v. *Winmill;* 305 U. S. 79, 83; *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459, 466), because Congressional approval of the interpretation is implied from reenactment (*National Lead Co.* v. *United States*, 252 U. S. 140, 146–147). The rule is *a fortiori* applicable to this, a "legislative" regulation,[7] be-

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under Section 214 (a) of the Revenue Act of 1921; Regulations 65 and 69, Article 216, issued under Section 214 (a) of the Revenue Acts of 1924 and 1926; Regulations 74, Article 236, issued under Section 23 (l) of the Revenue Act of 1928; Regulations 77, Article 230, issued under Section 23 (l) of the Revenue Act of 1932; Regulations 86, 94, and 101, Article 23 (m)–10, issued under Section 23 (m) of the Revenue Acts of 1934, 1936, and 1938; and Regulations 103, Section 19.23 (m)–10 and Regulations 111, Section 29.23 (m)–10, issued under the Internal Revenue Code, Section 23 (m). Article 215 of Regulations 45 (1920 ed.) made certain changes in Article 215 of Regulations 45 (1919 ed.) and in turn was amended by T. D. 3938, V–2 Cum. Bull. 117 (1926). See *Murphy Oil Co.* v. *Burnet*, *supra*. But the provisions dealing with the question here involved were not substantially changed.

[7] The Court has applied the reenactment doctrine in approving at least three "legislative" regulations dealing with depletion. *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299; *Burnet* v. *Thompson Oil & G. Co.*, 283 U. S. 301; cf. *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90. The *Murphy Oil Co.* case approved an integrally related section of the similar provision of Regulations 45, Article 215, under the 1918 Revenue Act. See discussion, p. 21, *infra*. In *Burnet* v. *Thompson Oil &*

cause of the greater probability that the responsible individuals in the legislative process were familiar with it since Section 23 (m) takes so much of its substance from the regulations. It may be said then with reality that if there were doubt as an original proposition whether the Commissioner has stayed within the bounds of his delegated authority, it has been dissipated by nine reenactments of the statute unchanged.[8] See Feller, Addendum to the Regulations Problem, 54 Harv. L. Rev. 1311, 1321 (1941).

But there is a more important reason for affording deference to this regulation than reenactment of the statute in itself. That consideration is stated as follows in *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90, 103:[9]

> In sum, the highly technical and involved factors entering into a practical solution of

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G. Co., supra, another regulation adopted under the 1918 Act was approved. The *Wilshire* case approved a regulation adopted under Section 23 (l) of the Revenue Act of 1926, containing the identical rule-making authority as Section 23 (m) of the Revenue Act of 1936, here involved.

[8] The situation is comparable to an express Congressional ratification of an unlawful exercise of delegated power. *Swayne & Hoyt, Ltd.*, v. *United States*, 300 U. S. 297.

[9] Sound administration of a complex law as justifying great weight to be attached to regulations has also been emphasized by commentators. Griswold, A Summary of the Regulations Problem, 54 Harv. L. Rev. 398 (1941); Paul, Studies in Federal Taxation (Third Series, 1940) 420; Brown, Regulations, Reenactment, and the Revenue Acts, 54 Harv. L. Rev. 377 (1941).

> the problem of depletion in administration of the tax laws points to the necessity of interpreting § 23 (1) so as to strengthen rather than to weaken the administrative powers to deal with it equitably and reasonably. These considerations are persuasive here not only in reaffirming the conclusion that the rule-making power existed, but also in concluding that restrictions on that power should not be lightly imposed where the incidence of such rules as are promulgated is prospective only.

It would be difficult to imagine a situation where the factors enunciated in the *Wilshire Oil* case have more applicability than to the regulation before the Court, because (1) it deals with "the highly technical and involved facts entering into a practical solution of the problem of depletion"; (2) its solution was expressly left by Congress to the Commissioner probably because the problem is so technical and is essentially administrative in character; and (3) it has remained unchanged for twenty-five years, relied upon by the Commissioner and taxpayers alike. In this posture only overwhelmingly important considerations can serve to invalidate the regulation.

2. Petitioners contend (Br. 24–31) that the depletion deductions in effect since 1918 are not related to or designed to compensate for the physical exhaustion of the depletable property and therefore are not hinged on production, but are merely designed to permit recovery of taxpayers'

investment out of income. They conclude that this purpose will be fully accomplished by the adjustment of the basis downward (whether by actual depletion or by anticipated depletion that does not occur) until the taxpayer ends up with a zero basis, after which no further deductions will be allowed, thus protecting the revenues.

Assuming the correctness of the premise, it is difficult to see how the revenues of the Government would be protected by a device which would permit income to escape taxation with no assurance that it would be recouped from a future sale of the property at a profit over the reduced basis.[10]

But the fundamental error is in the premise. It is not true that the 1918 Act and subsequent statutes are not designed to compensate for physical exhaustion of the mineral reserve. These statutes deal with "depletion" as did those that preceded them, and there is nothing in the legislative history to indicate that Congress meant to provide for a totally different kind of allowance. H. Rep. No. 767, 65th Cong., 2d Sess., p. 10 (1939–1 Cum. Bull. (part 2), 86, 93); S. Rep. No. 617, 65th Cong., 3rd Sess., p. 8 (1939–1 Cum. Bull. (part 2), 117, 122); H. Conf. Rep. No. 1037, 65th Cong., 3rd Sess., p. 50 (1939–1 Cum. Bull. (part 2), 130, 136). What was accomplished by the 1918 Act, apart from provision for depletion

[10] See discussion, *infra*, pp. 24–26.

based on discovery value, was a removal of limitations imposed under earlier Acts which did not insure full compensation for the cost of mineral actually removed, and the delegation to the Commissioner of authority to adopt regulations which would effect such an allowance.[11] There is nothing in the whole history of depletion allowances that suggests that depletion is not compensation for exhaustion.

As this Court has often recognized under all of the Revenue Acts (*United States* v. *Ludey*, 274 U. S. 295; *Anderson* v. *Helvering*, 310 U. S. 404; *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362), the function of the depletion deduction is to

[11] Under Section II B of the Revenue Act of 1913, c. 16, 38 Stat. 114, 167–168, the allowance was 5% "of the gross value at the mine of the output" for the year for which the computation was made. This Court recognized in *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103, that that allowance was inadequate, but held the statute not invalid for that reason, since a depletion allowance is a matter of grace. See also *Burnet* v. *Thompson Oil & Gas Co.*, *supra*. No allowance need be granted, for the reason that the proceeds of mining and oil operations are not proceeds of the sale of property but gross income. *Stratton's Independence* v. *Howbert*, 231 U. S. 399; *Von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503. Section 5 (a) Eighth (b) of the Revenue Act of 1916, c. 463, 39 Stat. 756, gave to the Secretary of the Treasury authority to make regulations providing for "a reasonable allowance" subject to the qualification that "the allowance" should not "exceed the market value in the mine of the product thereof, which has been mined and sold during the year for which the return and computation are made * * *." The 1918 Act removed the qualification and, in addition, provided for discovery depletion.

compensate the owner of the mineral-in-place for the wasting away of his capital asset. When there is production, there is a wasting away; without production there is none. Thus if there were no production there would be no need for depletion deductions.[11a]

Petitioners do not dispute the foregoing facts but seek rather by emphasis on certain provisions of the regulations to obscure them. And it is the regulations, not the statute, on which petitioners must rely for the apparent departures from a wholly logical structure on which they base their charge that depletion is to no degree keyed to production. The statute affords them no support. Since 1918 it has been without variation herein material (Sec. 23 (m), Revenue Act of 1936, Appendix A, *infra*, p. 40):

> "*Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, * * *."

[11a] Authorization of percentage depletion emphasized rather than altered the fundamental theory of the allowance. *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459, 467. In fact, the petitioners "investment" theory breaks down completely under percentage depletion, for such depletion continues after the investment has been recovered from income.

It is from the regulations implementing this provision and particularly from those applying to advance royalties that petitioners draw ammunition to attack that other provision in the regulations which is onerous to them.

The regulations, first promulgated under the 1918 act, established a system regarding the treatment of advance royalties designed to work most equitably in the majority of cases. Thus, in recognition of the fact that where advance royalties have been paid production will usually eventually be begun, provision was made that depletion deductions could be taken from such advance royalties without awaiting actual production. But provision had to be made as well for the exceptional case where production did not ensue. Instead of providing for a revision of the depletion deduction in earlier years, many of which would be barred by the statute of limitations, and in line with the treatment accorded similar problems, such as amounts released from reserve accounts (see *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, 351–352),[12] provision was made that in the event no production occurred the taxpayer should add back to income in the year nonproduction became certain, amounts equal to the depletion deductions taken on the advance royalties. These provisions represent an integrated scheme established by the Commis-

[12] See also the comparable treatment in an analogous problem upheld in *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, and cases discussed, *infra*, p. 30.

sioner pursuant to specific statutory mandate, and as observed above there is considerable reason for belief that Congress is satisfied with it.

In its primary aspect, that of allowing depletion deductions in advance of production, this integrated scheme has been upheld and interpreted in *Murphy Oil Co.* v. *Burnet,* 287 U. S. 299, and *Herring* v. *Commissioner,* 293 U. S. 322. Petitioners now seize upon these decisions to tear apart the integrated scheme: thus, they argue (Br. 14–21) from these decisions that they have a right under the statute to deduct depletion in advance of production, and they conclude that as the regulation here involved would qualify that right it is invalid. A fatal weakness in their argument is that it is the regulation, approved in those decisions, and not the statute except derivatively which gives them the right to advance depletion, and under that regulation the right is not absolute but is qualified by the provision they now attack.

The statute, which leaves the details of the scheme to the Commissioner, would thus not have been offended had the regulations chosen to deny all depletion deductions on advance royalties until production had begun and then to permit the deductions to be taken cumulatively. Such a solution would have avoided the problem herein presented, but at the expense of working some injustice through wasted deductions on lessors on whose properties production is eventually begun,

who doubtless are a more numerous class than persons such as petitioners. Had such a solution been chosen petitioners would have had no depletion deductions at all, which forcibly demonstrates that petitioners' right to the deduction flows not from any command of the statute but from the regulations embodying the administrative scheme.

The keystone on which petitioners base their argument, *Murphy Oil Co.* v. *Burnet, supra,* shows clearly that while taxpayers have the right to depletion deductions from advance royalties, that right stems from the regulations. The whole question there was whether the regulations could validly require the deduction to be taken in advance of production. This Court considered the integrated scheme presented in the regulations and concluded that it represented a fair solution of the problem the Commissioner had to contend with. And the Court referred (287 U. S. 299, 306–307) to the provisions herein involved, and observed with evident approval that they completed the pattern. We submit that the Tax Court correctly gave great weight to this opinion, for in concluding that the integrated scheme represented a fair solution to the problem the Court necessarily considered and approved the essential component herein under attack.[13]

[13] Petitioners erroneously contend (Br. 10) that the statement in *Herring* v. *Commissioner*, 293 U. S. 322, 328—

> As to income tax liability in the year of termination of the lease, on account of bonus paid at the execution

3. One of the major contentions of petitioners directed against the validity of the regulation is that (Br. 14)—

> The Untaxed Royalties of Prior Years were Capital Recoveries in Those Years Under Sections 23 (m), 114 (b) (1), and 113 (b) (1) (B), Resulting in Permanent Reduction of Basis and Hence Cannot Be Treated as Income for Any Year or Years; * * *.

This position is based, in part, on the erroneous assumption already discussed that Section 23 (m) unconditionally allows depletion on advance royalties irrespective of production.

The argument grounded on the basis provisions of the statute is equally without support. There is nothing in Section 23 (m), Section 113, or Section 114 which precluded the Commissioner from

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of the lease, if no mineral has then been extracted, we express no opinion.

makes it clear that the *Murphy Oil Co.* opinion was not a holding on the validity of Article 23 (m)–10 (c). The *Herring* case involved percentage depletion, whereas cost depletion is involved here (R. 46) and was involved in the *Murphy Oil* case. Percentage depletion and its relation to paragraph (c) raises problems not common to cost depletion (see dissenting opinion of Judge Hutcheson in *Crabb* v. *Commissioner*, 119 F. 2d 772, 774–776 (C. C. A. 5th)), although the Commissioner has taken the position that (c) applies to percentage depletion (G. C. M. 14448, XIV–1 Cum. Bull. 98, 100–101 (1935), Appendix B, *infra*, pp. 46–51), and this position has been sustained by the courts. *Crabb* v. *Commissioner*, *supra*; *Sneed* v. *Commissioner*, *supra*; *Houston Farms Development Co.* v. *United States*, *supra*.

requiring by regulation that amounts such as are here involved should be taxed as income and simultaneously restored to capital account as a basis for any future depletion. Section 23 (m) of the Revenue Act of 1936 provides in part that—

> In any case in which it is ascertained *as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof,* then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. * * * [Italics supplied.]

While petitioners admit, as indeed they must, that this provision does not apply "directly" to their case, they urge that it establishes a Congressional intention that the depletion basis should not be restored on cancellation of a lease without production (Br. 18–19).

We submit that not only is the provision plainly inapplicable here, but the legislative history makes it clear that Congress, in adopting the above provision, did not contemplate situations beyond the class carefully described in the statutory language.[14] Moreover, the attempt to at-

[14] This provision of Section 23 (m) first came into the Revenue Acts as Section 23 (l) of the Revenue Act of 1932. The Report of the Senate Finance Committee (S. Rep. No.

tribute to the statutory language a definite policy prohibiting an adjustment of basis for any reason is contrary to the broad discretion delegated to the Commissioner to provide "a reasonable allowance for depletion." This conclusion is reinforced by the essentially different problems posed by incorrect estimates of the number of recoverable units and cancellation of a lease without production. In the former situation, by hypothesis, there has been production as a result of which it is known with greater certainty that more or less units will be recovered than previously estimated. The adjustment provided by Section 23 (m) in the case, for example, of a prior underestimate of recoverable units is fair to the Government and taxpayer alike since by decreasing the amount of depletion attributable to each unit of future production, depletion will equal extraction. But when, as in the instant case, there is cancellation of a lease without any production, although the lessee has made large payments in royalties, it will often be the case that there will never be extraction because no minerals exist or none exist in

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665, 72d Cong., 1st Sess., p. 16 (1939–1 Cum. Bull. (Part 2), 496, 507–508) accompanying that Act, states:

"The House bill requires a change in the annual depletion allowance where a new estimate of the number of the recoverable units is made in the light of subsequent events. The effect of the amendment is shown by the following example:

"A purchased for $1,000 an ore body with estimated recoverable units of 1,000. He removes 500 units and takes

commercial quantities."[18] To say that the Government-taxpayer account will be adjusted in such cases by reducing the amount of depletion attributable to each unit of mineral extracted in the future is to allow depletion where none has been suffered or ever will be. In view of the Congressional purpose in providing for depletion deductions, such an allowance would be unreason-

depletion deductions aggregating one-half of his cost, or $500. Subsequently it is ascertained that there remain in the mine 1,500 recoverable units and the original estimate of 1,000 recoverable units is revised. Under the amendment, his unrecovered cost ($1,000 less $500) would be spread over the revised estimate of the recoverable units (1,500) with the result that on each unit thereafter removed he would be allowed a depletion deduction of 33⅓ cents per unit instead of $1 per unit.

"The provision in the House bill has been amended so as to make it clear that it is also to apply where the revision of the estimate of recoverable units results from day-to-day operations."

See also Report of the Conference Committee (H. Conference Rep. No. 1492, 72d Cong., 1st Sess., p. 11 (1939–1 Cum. Bull. (Part 2) 539, 540). The explanation of the amendment in the House of Representatives by Congressman Vinson confined its scope to the situation described in the Senate Report. 75 Cong. Record, Part 7, p. 7233.

[18] This is in part recognized by petitioners who state (Br. 15, fn. 13):

"It should be noted that, although the termination of a lease is a serious economic blow to the property, such termination, in the case of a proven mine, does not destroy anticipation of future production."

But often unproven mines are leased, as may have been the situation here so far as the record indicates. And even so-called "proven" mines may turn out to have far less than the anticipated deposits.

able. Accordingly, the clause of Section 23 (m) on which petitioners rely in no way limited the Commissioner's authority to provide a "reasonable allowance for depletion," and, if at all relevant here, suggests that he did not exceed his authority in providing in Article 23 (m)–10 (c) that—

> If for any reason any such mineral lease expires or terminates or is abandoned before the mineral which has been paid for in advance has been extracted and removed, the lessor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed * * *.

Contrary to petitioners' argument (Br. 15–18) this provision is also not inconsistent with the basis provisions of the statute contained in Sections 113 and 114 of the Revenue Act of 1936, but rather finds authorization in them. Section 114 (b) (1), (Appendix A, *infra*, p. 42), as petitioners agree (Br. 17), provides that the basis upon which depletion is to be allowed shall be the adjusted basis provided in Section 113 (b). They argue from Section 113 (b) (1) (B), (Appendix A, *infra*, p. 41), that to the extent that depletion deductions have been taken in previous years, basis is permanently reduced because Section 113 (b) (1) (B) provides that proper adjustment shall be made in all cases for depletion "to

the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws." But they completely disregard Section 113 (b) (1) (A) (Appendix A, *infra*, p. 41), which provides that *proper adjustment* in respect of the property shall *in all cases be made*—

> for expenditures, receipts, losses, or other items, properly chargeable to capital account, * * * but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years.

This provision clearly allows an adjustment to basis because depletion deductions previously taken fall within the phrase "other items, properly chargeable to capital account," when no extraction will occur because of cancellation of a lease. We have pointed out that depletion is an allowance for a decreasing capital investment in the minerals in place. The propriety of adjusting the capital account to reflect the fact that the capital investment remains intact where there has been no extraction seems obvious. And that is exactly what the Commissioner has done in Article 23 (m)–10 (c). As a matter of mechanics, particularly in a case where there has been some production, the depletion deductions allowed or allowable stand as an adjustment to the original basis, but there is an offsetting adjustment for

the amount taken which, in fact, represented no exhaustion and is required to be reported as income. Whether subsection B is construed as imposing a limitation on subsection A or permitting an offsetting adjustment is immaterial, since the result in either case is the same.

If any doubt remains whether such adjustment made by the regulation is within the contemplation of Section 113 (b) (1) (A), it is resolved by the opinion of the Court in *Dobson* v. *Commissioner*, Nos. 44–47, decided December 20, 1943, rehearing denied, February 14, 1944, not yet reported. The Court there said:

> The argument relies upon § 113 (b) (1) (A) of the Internal Revenue Code, which provides for adjusting the basis of property for "expenditures, receipts, losses, or other items properly chargeable to capital account." This provision, it is said, requires that the right to a deduction for a capital loss be treated as a return of capital. Consequently, by deducting in 1930 and 1931 the entire difference between the cost of his stock and the proceeds of the sales, taxpayer reduced his basis to zero. But the statute contains no such fixed rule as the Government would have us read into it. It does not specify the circumstances or manner in which adjustments of the basis are to be made, but merely provides that "Proper adjustment * * * shall in all cases be made" for the items named if "properly chargeable to

capital account." What, in the circumstances of this case, was a proper adjustment of the basis was thus purely an accounting problem and therefore a question of fact for the Tax Court to determine. Evidently the Tax Court thought that the previous deductions were not altogether "properly chargeable to capital account" and that to treat them as an entire recoupment of the value of taxpayer's stock would not have been a "proper adjustment." We think there was substantial evidence to support such a conclusion.

If, in the *Dobson* case, in the absence of a regulation, the Tax Court had broad authority to determine what constituted a proper adjustment to capital account under Section 113 (b) (1) (A), obviously the Commissioner here had equally broad authority to issue regulations providing for proper adjustments to capital account in such a case as this one. This is particularly true here, because the problem cannot be divorced from that of providing for "a reasonable allowance for depletion," the exact formula for which Congress purposely and expressly left to the Commissioner.[16]

4. The regulation is not unreasonable on the ground argued by petitioners (Br. 31–41), that it taxes income in a year in which no cash or other

[16] The Court in *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299, 306–307, in effect approved the Commissioner's method of making "necessary capital readjustments."

property is received. In other analogous situations and independently of regulations, the courts have held that income [17] is realized in the year in which the character of an earlier payment is first determined and in many instances no money or other property was received in the tax year. *Maryland Casualty Co.* v. *United States*, 251 U. S. 342; *Helvering* v. *Bruun*, 309 U. S. 461; *Doyle* v. *Commissioner*, 110 F. 2d 157 (C. C. A. 2d), certiorari denied, 311 U. S. 658; *Commissioner* v. *Dallas Title & Guar. Co.*, 119 F. 2d 211 (C. C. A. 5th); *Warren Service Corp.* v. *Commissioner*, 110 F. 2d 723, 724 (C. C. A. 2d); *Virginia Iron Coal & C. Co.* v. *Commissioner*, 99 F. 2d 919 (C. C. A. 4th), certiorari denied, 307 U. S. 630; *Baird* v. *United States*, 65 F. 2d 911 (C. C. A. 5th), certiorari denied, 290 U. S. 690; *Bourne* v. *Commissioner*, 62 F. 2d 648 (C. C. A. 4th), certiorari denied, 290 U. S. 650.

Petitioners' argument (Br. 42–43) that the regulation is at variance with Sections 41 and 42 of the Revenue Act of 1936, providing that net income is to be computed on the basis of the taxpayers' annual accounting period, and the decision of the Court in *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, is based on a fundamental misconception of the income concept in federal taxation as just explained. Their understanding ap-

[17] As used in Section 22 (a) of the Revenue Act of 1936 and identical sections in other acts.

parently is that income is only realized in the year when money is received. But since, as we have shown, income was received when it was finally known that the amounts received in earlier years were clear profit and not reimbursement for the wasting mineral reserve, the inclusion in income in 1937 is a consequence of, and not inconsistent with, the annual structure of the income tax.

But even if the regulation did depart from the annual accounting structure of the Revenue Act as embodied in Sections 41 and 42, it is no objection to its validity because Section 23 (m) delegated to the Commissioner the authority to prescribe the method of determining "a reasonable allowance for depletion." And if in so doing he departed from the annual system, it would be within the broad authority conferred by Section 23 (m).[18]

Petitioners' complaint that the regulation imposes a "penalty" (Br. 31–41) is also based on their misapprehension of the income concept. There is a "penalty" only if what was income in a series of previous years is arbitrarily put in in-

[18] Petitioners inconsistently argue (Br. 13) that a more equitable solution of the problem lies in the Commissioner using his regulation-making power to open up the statute of limitations and restore to income amounts equal to depletion deductions for the years in which the deductions were taken. Such a solution would be as inconsistent with Section 275 (a) of the Revenue Act of 1936, providing for a three-year period of limitation, as is paragraph (c) with Sections 41 and 42, even if petitioners' analysis were correct.

come in the tax year. But as we have shown, the amounts equal to the depletion deductions did not become income until 1937.[19] The result is not only not a penalty, but any other result would permit income to escape taxation. In any event, as both the Board (R. 49–50) and Circuit Court pointed out (R. 80–81), the so-called hardship is not a necessary result of the regulation. If the taxpayers had had large incomes in the years of depletion deductions and a small income in 1937, they may well have had an over-all tax saving. Similarly, if there had been a period of falling tax rates, the result may have been reversed. Again, the argument amounts to a complaint directed at the annual system of taxation which necessarily operates to impose a large tax in the year when a large amount of income is realized with no necessary relation to the periods to which under some other system the income might be attributed.

II

THE REGULATION IS VALID WITHOUT TAX BENEFIT QUALIFICATION

1. In reaching the conclusion that amounts equal to depletion deductions in prior years were income in 1937, the Board excluded the sum of

[19] Amounts actually received in several other years were included in income in one year in *Doyle* v. *Commissioner, supra; Virginia Iron Coal & C. Co.* v. *Commissioner, supra;* and *Commissioner* v. *Dallas Title & Guar. Co., supra.*

$4,958.05 deducted in 1937 by Mrs. Douglas because she sustained a net loss in 1933 and therefore had received no tax benefit from the deduction. (R. 52.) The Circuit Court of Appeals, we submit, properly concluded (R. 81) "That it [tax benefit principle] is not in accordance with law, making it our duty to reverse under the statute. 26 U. S. C. § 1141 (c) (1), Supp. 1939." It is a question of law because Article 23 (m)–10 (c) provides that—

> the lessor shall adjust his capital account by restoring thereto the *depletion deductions* made in prior years * * *, and a *corresponding amount* must be returned as income * * * [Italics supplied.]

Clearly the language of the regulation is not susceptible of "tax benefit" qualification. Cf. *Virginian Hotel Corp.* v. *Helvering,* 319 U. S. 523.[20] The problem here is therefore essentially that of Point I, *supra,* namely, the validity of the regulation. As such the considerations which we urged there are equally apropos.

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[20] There it was held that excessive depreciation taken in earlier years reduced the depreciation basis regardless of tax benefit where the statute provided that the basis for depreciation is cost of property with adjustments for depreciation to the extent "allowed (but not less than the amount allowable)." The majority was of the opinion that any deduction taken, if not challenged by the Commissioner, was "allowed." *A fortiori* since the regulation provides that an amount equal to the "depletion deduction" is income, it cannot be interpreted as being limited by the tax benefit concept.

Reliance on *Dobson* v. *Commissioner,* Nos. 44–47, decided December 20, 1943, rehearing denied, February 14, 1944, not yet reported (Br. 61–62), to support the application of the tax benefit qualification is misplaced. The Court there emphasized that "We are not adopting any rule of tax benefits." What it did hold, to use the Court's language, was that—

> We only hold that *no statute or regulation having the force of one* and no principle of law compels the Tax Court to find taxable income in a transaction where as *matter of fact* it found no economic gain and no use of the transaction to gain tax benefit. * * * [Italics supplied.]

In this case a regulation is in force which in unambiguous terms required, without qualification as to tax benefit, that amounts equal to the depletion deducted in previous years with respect to advance royalties are to be included in income when the lease is terminated without extraction. The Tax Court was therefore compelled to hold that even though Mrs. Douglas derived no tax benefit from depletion allowed with respect to advance royalties in 1933, an amount equal to that depletion must be returned as income in 1937, unless the regulation lacked the force of law because inconsistent with the statute.

Whether it was inconsistent with the statute is

a pure question of law.[21] The *Dobson* opinion expressly safeguards Treasury Regulations from modification by the Tax Court based on its opinion as to what constitutes a better rule.[22] Yet

[21] Even if the case involved a preliminary question whether the regulation properly interpreted excluded the tax benefit theory, the question would still be a question of law. The question of the construction and interpretation of the regulations is one which Congress specifically intended the Circuit Court of Appeals to review. The House Report on the Revenue Bill of 1926 expressly states that the Circuit Court of Appeals "upon review may consider, for example, questions as to * * * the proper interpretation and application of * * * any regulation having the force of law * * *." H. Rep. No. 1, 69th Cong., 1st Sess., pp. 19–20 (1939–1 Cum. Bull. (Part 2) 315, 328–329).

On this question the *Dobson* opinion itself states:

"It is contended that the applicable statutes and regulations properly interpreted forbid the method of calculation followed by the Tax Court. If this were true, the Tax Court's decision would not be 'in accordance with law' and the Court would be empowered to modify or reverse it. Whether it is true is a clear-cut question of law and is for decision by the courts."

Cf. *The Security Flour Mills Co.* v. *Commissioner*, No. 276, decided February 28, 1944.

[22] Moreover, any practical considerations which may have influenced the Court not to disturb the Tax Court's decision in the *Dobson* case do not exist where a regulation is involved. The Bureau of Internal Revenue, not the Tax Court, is the administrative agency charged with the adoption of rules and regulations to implement and interpret the tax laws. It is staffed to perform that duty and has had long experience in that field. The Tax Court has been given no authority to adopt regulations of its own or to modify regulations issued by the Commissioner and is not functionally qualified for such an undertaking. Its power of review with respect to regulations is precisely the same as that of the courts, namely, to determine whether the regulation is consistent with the statute.

that is precisely what the Tax Court has done in this case.

2. There remains to consider the reasonableness of Article 23 (m)–10 (c) from the point of view of its failure to incorporate the tax benefit theory. This has been largely answered by the discussion in Point I. For reasons there stated the statute did not require that any depletion be allowed with respect to the advance royalties before extraction. *A fortiori* it did not require that if such an allowance were made, it could be made conditional on the restoration of the amounts to income in the year of termination of the lease without extraction, only to the extent that a tax benefit was derived in the years of the depletion allowances. Petitioners complain (Br. 61, 63) that since the only reason for including the amounts in question in income in 1937 is that they were not entitled to the depletion deductions previously taken, there is no justification for including any of the amounts in income that did not serve to reduce tax liability. But, as we have emphasized, the amounts should be included in income in 1937, not to correct an earlier error but because in that year they were for the first time realized income. The contingency, extraction of ore, was eliminated by cancellation of the lease and income was for the first time realized. See *Maryland Casualty Co.* v. *United States, supra; Helvering* v. *Bruun, supra;* and *Doyle* v. *Commissioner, supra.* Whether the taxpayer received a

tax saving in the years in which that part of the royalties which represented depletion were in effect excluded from income, is, on this analysis, incapable of altering the status of the amounts as income in 1937.

The Board's error in reaching a contrary conclusion is shown by its reason for applying the tax benefit theory which is in its language as follows (R. 52):

> Where there is recovery in respect of a loss sustained in an earlier year and a deduction of such loss claimed and allowed for the earlier year had effected an offset in taxable income, the amount recovered in the later year should be included in taxable income for the year of recovery, *the reason being that even though the subsequent recovery is in the nature of a capital recovery the prior deduction of the amount of the loss from taxable income has for income tax purposes already given the taxpayer a recoupment of said loss out of taxable income and the subsequent recovery, being in the nature of a replacement of taxable income, is equivalent to gain to the taxpayer. National Bank of Commerce of Seattle* vs. *Commissioner*, 115 Fed. (2d) 875, affirming 40 B. T. A. 72. But where the deduction claimed and allowed in the prior year did not effect an offset of taxable income, the amount recovered in a later year does not constitute taxable income for the year of recovery. *Estate of James N. Collins, supra.* [Italics supplied.]

The theory that a loss recovery is treated as income although actually it is a return of capital, because *taxwise* the capital was recouped to the extent of a tax benefit, has no applicability to the facts of this case. The amounts here involved were income not because of a prior capital recoupment taxwise, but because their status as income first became established in the tax year. On the Board's analysis properly applied there was no recoupment of capital in the tax year but a realization of income. Accordingly, even were there not a controlling regulation, the Board must be reversed because its decision is without support in the record.

3. Petitioners state that in 1934, Bessie P. Douglas received no tax saving from $839.90 of her depletion deduction (Br. 62) and similarly in 1932, the estate of Charles H. Robinson received no tax reduction as a result of $379.13 of the depletion deduction (Br. 63). It is contended from this that the amounts included in income in 1937 should be reduced, *pro tanto*. For the reasons set forth with respect to Mrs. Douglas' 1933 deduction such considerations are irrelevant.

Even if the Court should disagree with us as to that situation there are additional considerations for not reducing taxable income in 1937 where there was net income after deductions, though no tax saving resulted. The Board found with respect to the 1934 depletion deduction of Mrs. Douglas and the 1932 deduction of Robin-

son's estate that income was offset (R. 52). Thus the Board refused to give effect, in determining tax benefit, to the credits each had in the years in question. There is statutory justification for the treatment. Whatever the similarity in practical effect between a deduction and a credit in a given case, the statute plainly distinguishes between the two. The deductions offset gross income. The credits are subsequently taken into account in the computation of the tax. The statutory scheme treats the deductions as offsetting the gross income, not the credits. We can perceive no basis for treating the credits as having this effect. In any event it cannot be said that the Board's treatment of the problem was without legal justification. *Dobson* v. *Commissioner, supra.* In that case the Court refused to go behind the Tax Court's conclusion on this very issue.

CONCLUSION

The judgment below should be affirmed.

Respectfully submitted.

CHARLES FAHY,
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SAMUEL O. CLARK, JR.,
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MARCH 1944.

APPENDIX A

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. * * *

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

(A) for expenditures, receipts, losses, or other items, properly chargeable to capital account, including taxes and other carrying charges on unimproved and unproductive real property, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years;

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. Where for any taxable year prior to the taxable year 1932 the depletion allowance was based on discovery value or a percentage of income, then the adjustment for depletion for such year shall be based on the depletion which would have been allowable for such year if computed without reference to discovery value or a percentage of income;

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for Depletion.*—

(1) *General Rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 23 (m)–10. *Depletion—Adjustments of accounts based on bonus or advanced royalty.*

(a) If a lessor receives a bonus in addition to royalties, there shall be allowed as a depletion deduction in respect of the bonus an amount equal to that proportion of the basis for depletion as provided in section 114 (b) (1) or (2) which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received. Such allowance shall be deducted from the lessor's basis for depletion, and the remainder is recoverable through depletion deductions on the basis of royalties thereafter received.

(b) If the owner has leased a mineral property for a term of years with a requirement in the lease that the lessee shall extract and pay for, annually, a specified number of tons, or other agreed units of measurement, of such mineral, or shall pay, annually, a specified sum of money which shall be applied in payment of the purchase

price or royalty per unit of such mineral whenever the same shall thereafter be extracted and removed from the leased premises, an amount equal to that part of the basis for depletion allocable to the number of units so paid for in advance of extraction will constitute an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by the lessor shall be claimed or allowed in any subsequent year on account of the extraction or removal in such year of any mineral so paid for in advance and for which deduction has once been made.

(c) If for any reason any such mineral lease expires or terminates or is abandoned before the mineral which has been paid for in advance has been extracted and removed, the lessor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned.

(d) In lieu of the treatment provided for in the above paragraphs the lessor of oil and gas wells may take as a depletion deduction in respect of any bonus or advanced royalty from the property for the taxable year 27½ percent of the amount thereof; and the lessors of sulphur mines, metal mines, and coal mines may take as a depletion deduction in respect of any bonus or advanced royalty from the property for the taxable year beginning after December 31, 1935, for which he first makes

return in respect of the property (and for subsequent taxable years in case an election to have depletion computed on a percentage basis has been exercised in the proper return) 23 percent, 15 percent, and 5 percent, respectively, of the amount thereof; but the deduction shall not in any case exceed 50 percent of the net income of the taxpayer (computed without allowance for depletion) from the property.

ART. 23 (m)–11. *Depletion and depreciation accounts on books.*—Every taxpayer claiming and making a deduction for depletion and depreciation of mineral property shall keep accurate accounts in which shall be recorded the cost or other basis provided by section 113 (a), as the case may be, of the mineral deposit and of the plant and equipment, together with subsequent allowable capital additions to each account and all of the other adjustments required by section 113 (b).

If the plan or method of depletion and depreciation accounting adopted by the taxpayer has once been approved by the Commissioner, it cannot be changed by the taxpayer without the consent of the Commissioner. These accounts shall thereafter be credited annually with the amounts of the depletion and depreciation computed in accordance with articles 23 (m)–2, 23 (m)–3, 23 (m)–4, or 23 (m)–5; or the amounts of the depletion and depreciation so computed shall be credited to depletion and depreciation reserve accounts, to the end that when the sum of the credits for depletion and depreciation equals the cost or other basis of the property, plus subsequent allowable capital additions, no fur-

ther deductions for depletion and depreciation with respect to the property shall be allowed, except such depletion deductions as may thereafter be allowable under section 114 (b) (2), (3), or (4) and articles 23 (m)–3, 23 (m)–4, or 23 (m)–5.

* * * * * *

APPENDIX B

G. C. M. 14448, XIV–1 Cum. Bull. 98 (1935):

* * * * *

I

The opinion of the court in *William E. Herring* v. *Commissioner,* supra (which arose under the Revenue Act of 1926), may be summarized as follows:

1. A bonus is payment in advance for oil and gas to be extracted (advance royalty) and is, therefore, taxable income (*Burnet v. Harmel,* 287 U. S. 103, Ct. D. 611, C. D. XI–2, 210; *Murphy Oil Co.* v. *Burnet,* 287 U. S. 299, Ct. D. 619, C. B. XII–1, 231; and *Bankers Pocahontas Coal Co.* v. *Burnet,* 287 U. S. 308); as such, it is a part of the "gross income from the property" as that phrase is used in section 204 (c) 2 of the Revenue Act of 1926 to designate the *base* for the application of the percentage depletion deduction. Given "gross income from the property," which is the *base,* and the authority as provided in section 204 (c) 2, in the case of oil and gas wells, to compute the depletion allowance at a percent of such base, the question whether the amount so computed comes within the *grant* in the statute (section 214 (a) 9 of the Revenue Act of 1926, for the purposes of this case) of "a reasonable allowance for depletion" is not controlled by the fact that there was no extraction of oil or gas in the

year for which the allowance is claimed, or by the fact that in such year there was no practical assurance of production in the future.

2. The conditions prescribed for the allowance of bonus depletion on the cost basis and on the percentage of income basis must be the same for the reason that "the nature and purpose of the allowance is the same in both cases." (*United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459.)

3. The grant as a deduction from gross income of a reasonable allowance for depletion "in the case of oil and gas wells" has been the same under all the Revenue Acts, 1916 to 1934, inclusive. As to *cost depletion,* the regulations of the Bureau under the Revenue Act of 1926 and prior Revenue Acts treated a bonus or advance royalty as subject to depletion and those regulations have been approved by the reenactment of the statutory provisions without alteration. (*Murphy Oil Co.* v. *Burnet,* supra.) "It has never been held here [in the Supreme Court] that the existence of a well conditioned the allowance. Nor, until recently, has the Treasury so ruled." The situation presented by recent administrative rulings (including decisions of the Board of Tax Appeals) is that if the taxpayer computes depletion upon the basis of cost or March 1, 1913, value, he may deduct depletion from a bonus payment irrespective of the sinking of a well or the production of any oil or gas (see regulations of the Bureau discussed in *Murphy Oil Co.* v. *Burnet,* supra); but if the taxpayer elects to avail himself of the alternative method of computing the deduction at a per cent of gross income, "though the

nature of the deduction is unchanged" (*United States* v. *Dakota-Montana Oil Co.*, supra), he is not entitled to any deduction for depletion unless there is production within the taxable year, no matter how small such production may be. However, if there is a *base* provided by statute for the computation of the allowance, it is improper in the one case, i. e., when computed on the percentage of income basis, to condition the bonus depletion allowance by the test of actual production, or the imminent probability of production, or by any refinements as to the degree of probability of future production, and at the same time to allow the deduction if computed on *the cost basis* "irrespective * * * of the production of any oil or gas." The court concluded that there is no "statutory authority or logical justification for withholding it in the one and granting it in the other."

4. Therefore, a depletion deduction on the percentage of income basis is allowable against a bonus payment in the year of the receipt of the payment irrespective of the fact that in such year "there was no extraction of oil or gas, and no practical assurance of production in the future."

II

The purpose of the depletion allowance on the *cost* basis is to provide for the return to the owner of mineral deposits, whether freehold or leasehold, *the value of his property on the basic date* (plus subsequent allowable capital additions), "but not including land values for purposes other than the extraction of minerals." (See article 201, Regulations 69, and the

corresponding provisions of subsequent regulations.) Therefore, a condition precedent to the allowance of bonus depletion on that basis (under article 216 (a), Regulations 69, and the corresponding provisions of subsequent regulations) is a determination of a mineral value in the property at the date of acquisition (if depletion is to be based on *actual cost*), or at a basic date otherwise prescribed by law (as in the case of depletion based on March 1, 1913, value). If no mineral value in the leased premises can be shown as of the basic date, there is no capital sum returnable through depletion and there is *no base* for the allowance of depletion against a bonus payment or any other income from mineral extraction. From this there was developed the administrative rule set forth in I. T. 2361 (1927) (C. B. VI–1, 73), to the effect that article 216 (a), of Regulations 69 (relating to bonus depletion), has no application to a bonus received by the lessor of an *unproven area* and is applicable only to a lease of property in a *proven area* where the mineral content was capable of being estimated at the time the bonus was received even though the property was nonproducing at that time. If, at the time of the execution of the lease, the leased premises were in an unproven area, it follows that a mineral value at the basic date can rarely, if ever, be established. Where a mineral value can be established as of the basic date, a capital sum returnable through depletion can be ascertained at the execution of the lease, and, therefore, a bonus (being royalty in advance of extraction) may be treated as subject to depletion though it is received in advance

of actual production. (*Murphy Oil Co.* v. *Burnet,* supra.)

For the computation of depletion on the percentage of income basis, the *base* is the gross income from the property. Since the Supreme Court has held that a bonus received in advance of production is "gross income from the property" in the case of oil and gas wells, within the meaning of section 204 (c) 2 of the Revenue Act of 1926, and as such is a part of the *base* for the computation of the allowance, it follows that inasmuch as depletion may be allowed in anticipation of production, such a bonus is subject to depletion without the establishment of any other *base.* Under these circumstances, the distinction between bonuses for leases in proven and unproven areas (compare I. T. 2361, supra), which was carried forward by G. C. M. 11384, supra, and applied to claims for bonus depletion deductions on the percentage of income basis, cannot now be sustained. A depletion deduction on the percentage of income basis is, therefore, allowable in every case of a bonus payment received in advance of production. G. C. M. 11384 is hereby revoked.

III

In its opinion in *William E. Herring* v. *Commissioner, supra,* the Supreme Court made the statement that it expresses no opinion as to whether the amount allowed as a depletion deduction from the bonus payment in the year of the execution of the lease may be taxed as income to the lessor in the year of the termination of the lease where there has been no extraction of mineral from the leased premises. The allow-

ance of the deduction in the year of the execution of the lease rests upon an anticipation of production to avoid "the attendant inconvenience of indefinite postponement," as was said in *Murphy Oil Co.* v. *Burnet, supra.* The grant of the deduction is in any case upon the ground of "a reasonable allowance for depletion." If on the termination of the lease there has been no production, then there has in fact been no depletion. Ordinarily the Government may recoup only by restoring the deduction to income and asserting the tax against the taxpayer in the year of the termination of the lease. *Cost* depletion on an advance royalty has always been allowed on condition that if the anticipated production does not materialize, the taxpayer will restore the amount of the deduction to income as of the year the lease terminates, expires, or is abandoned. (See article 216 (b) and (c), Regulations 69, with which all prior and subsequent regulations are identical.) Since the "nature and purpose of the allowance is the same," as the Supreme Court has pointed out, whether the deduction be computed on the cost basis or on a percent of the gross income from the property, it follows that the taxpayer must be deemed to have taken the bonus depletion deduction on the percentage-of-income basis on the condition that he will restore the amount to such deduction to income as of the year of the termination of the lease where there has been no production from the leased premises.

ROBERT H. JACKSON,
Assistant General Counsel for the
Bureau of Internal Revenue.

U. S. GOVERNMENT PRINTING OFFICE: 1944

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 130

BESSIE P. DOUGLAS, *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE

No. 131

BESSIE P. DOUGLAS, *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE

No. 132

ESTATE OF CHARLES H. ROBINSON, NORTHWESTERN NATIONAL BANK AND TRUST COMPANY OF MINNEAPOLIS, JESSIE P. ROBINSON, et al., etc., *Petitioners,*

vs.

COMMISSIONER OF INTERNAL REVENUE

No. 133

BERNICE B. DALRYMPLE, *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF OF *AMICI CURIAE*

F. G. DAVIDSON, JR.
THEODORE L. HARRISON
J. DONALD RAWLINGS
W. A. SUTHERLAND
Amici Curiae

INDEX

TABLE OF CASES

	PAGE
Commissioner v. *United States & Int. Sec. Corp.*, 130 F. (2d) 894 (C. C. A. 3)	3
John V. Dobson, et al. v. *Commissioner*, Nos. 44-47, October Term, 1943 (rehearing denied February 14, 1944	2, 3, 4, 5, 6, 7, 8, 9
Gibson v. *Commissioner*, Dkt. #111781, memo. op. 12/31/43	7
Helvering v. *State-Planters Bank & Trust Co.*, 130 F. (2d) 44 (C. C. A. 4), 319 U. S.	3
Morris v. *Commissioner*, Dkt. #112279, memo. op. 1/3/44	7
R. Simpson & Co. v. *Commissioner*, No. 1, October Term, 1943, decided February 14, 1944	2
Virginian Hotel v. *Helvering*, 319 U. S. 523 (1943, rehearing denied October 11, 1943)	1, 2, 3, 5, 6, 7, 8, 9
Watson Est., Dkt. Nos. 110399, 111288, memo. op. 1/4/44	7

56 Harv. L. Rev. 1164	6
Regulations 103, Sec. 19.22 (b) (12)—1 as added by T. D. 5288, 1943-15 Int. Rev. Bull. 2	8

IN THE

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No. 131

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vs.

COMMISSIONER OF INTERNAL REVENUE

No. 133

BERNICE B. DALRYMPLE, *Petitioner*,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF AS *AMICI CURIAE*

The undersigned respectfully move this Honorable Court for leave to file the annexed brief as *amici curiae* in the above entitled cause.

Respectfully submitted,

F. G. DAVIDSON, JR.
THEODORE L. HARRISON
J. DONALD RAWLINGS
W. A. SUTHERLAND
Amici Curiae

IN THE

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BESSIE P. DOUGLAS, *Petitioner,*

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BERNICE B. DALRYMPLE, *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF OF *AMICI CURIAE*

The undersigned counsel herein for the Virginian Hotel and other taxpayers interested in the question there considered believe that *Virginian Hotel* v. *Helvering*, 319 U. S.

523 (1943, rehearing denied October 11, 1943), has in effect been overruled by the decision of this Court in *John V. Dobson, et al.* v. *Commissioner;* Nos. 44-47, October Term, 1943 (rehearing denied February 14, 1944). Counsel believe that this Court should take the opportunity afforded by the present case to overrule expressly the *Virginian Hotel* case and thus to clarify the confusion which now exists.

If in the present case the Court should hold Article 23(m)-10(c) of Regulations 94 valid as applied to situations where the depletion deductions in the earlier years resulted in the reduction of taxable income (an issue to which this brief is not addressed), the Court will then have to decide whether the Article mentioned applies to situations where the depletion deduction in the earlier years did not result in the reduction of taxable income. In support of the argument that it does so apply the government relies upon the *Virginian Hotel* case. This brief is addressed to the proposition that the *Virginian Hotel* decision does not now have the approval of this Court.

Counsel for Virginian Hotel were prepared to file a second petition for rehearing as soon as this Court ruled upon the petition for rehearing in the *Dobson* case. Counsel have refrained from doing so only because this Court had lost jurisdiction under its decision in *R. Simpson & Co.* v. *Commissioner*, No. 1, October Term, 1943, decided February 14, 1944, the same day on which petition for rehearing in the *Dobson* case was denied. The filing of petition for certiorari in another case presenting the same issue as that involved in the *Virginian Hotel* case is now under consideration if that becomes necessary to clarify the situation. We believe, however, that the Court can clarify the situation in its opinion in this case without the necessity of having the identical issue squarely placed before it again.

The majority of this Court in the *Virginian Hotel* case based its decision in favor of the Commissioner upon two fundamental conceptions—(1) that the construction of the word "allowed" in the bad debt cases controlled the con-

struction of the word "allowed" in the *Virginian Hotel* depreciation situation and that the decisions of the Circuit Courts of Appeals denying the tax benefit rule in the bad debt situation required the denial of the tax benefit rule in the *Virginian Hotel* depreciation situation; and (2) that in the absence of an express provision by Congress authorizing the application of the tax benefit rule, the Court could not read any such rule into the statute. In the *Dobson* case this Court expressed directly opposite conclusions with respect to each of these fundamental points.

The government in the *Virginian Hotel* case and in the *Dobson* case argued that the decisions of the Circuit Courts of Appeals denying the tax benefit rule in bad debt cases[1] (where the Regulations used the word "allowed", the same word used in Section 113 (b)(1)(B) involved in the *Virginian Hotel* case) were governing in the *Virginian Hotel* situation. In the *Virginian Hotel* case the majority of this Court accepted that argument and relied upon the decision of the Circuit Court of Appeals for the Fourth Circuit in *Helvering* v. *State-Planters Bank & Trust Co.*, 130 F. (2d) 44 in support of its holding that the word "allowed" in Section 113 (b)(1)(B) did not connote tax benefit. In the *Virginian Hotel* case the Court said:

> "It would take clear and compelling indications for us to conclude that 'allowed' as used in Sec. 113 (b)(1)(B) means something different than it does in the general setting of the revenue acts. See *Helvering* v. *State-Planters Bank & Trust Co.*, 130 F. 2d 44."

In considering the same argument advanced by the government in the *Dobson* case, this Court in its unanimous opinion recognized that the bad debt situation is analogous to the situations in the *Virginian Hotel* and *Dobson* cases, but expressly stated that the decisions of the Circuit Courts

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[1] *Helvering* v. *State-Planters Bank & Trust Co.*, 130 F. (2d) 44 (C. C. A. 4) and *Commissioner* v. *United States & Int. Sec. Corp.*, 130 F. (2d) 894 (C. C. A. 3).

of Appeals in the bad debt cases were erroneous. In the *Dobson* case this Court said:

> "It is argued on behalf of the Commissioner that the Court should overrule the Board by applying to this question rules of law laid down in decisions on the analogous problem raised by recovery of bad debts charged off without tax benefit in prior years. The court below accepted the argument. However, instead of affording a reason for overruling the Tax Court, the history of the bad debt recovery question illustrates the mischief of overruling the Tax Court in matters of tax accounting. Courts were persuaded to rule as matter of law that bad debt recoveries constitute taxable income, regardless of tax benefit from the charge-off. The Tax Court had first made a similar holding, but had come to hold to the contrary. Substitution of the courts' rule for that of the Tax Court led to such hardships and inequities that the Treasury appealed to Congress to extend relief. It did so. The Government now argues that by extending legislative relief in bad debt cases Congress recognized that in the absence of specific exemption recoveries are taxable as income. We do not find that significant in the amendment. A specific statutory exception was necessary in bad debt cases only because the courts reversed the Tax Court and established as matter of law a 'theoretically proper' rule which distorted the taxpayer's income. Congress would hardly expect the courts to repeat the same error in another class of cases, as we would do were we to affirm in this case."[2]

In view of the clear statement of the Court in its unanimous opinion in the *Dobson* case that the decisions in the

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[2] At this point in the Court's opinion appears footnote 36, reading in part as follows:

> "The question * * * arises not only in case of recoveries of previously charged off bad debts and recoveries of the type we have here. It is also present in case of * * * adjustments of *depreciation* and depletion or amortization, and other similar situations." (Emphasis supplied).

bad debt cases were erroneous, the decision in the *Virginian Hotel* case which is based squarely upon the authority of the bad debt decisions is clearly erroneous.

The second fundamental principle upon which the majority based its decision in the *Virginian Hotel* case is also clearly refuted by this Court's unanimous opinion in the *Dobson* case.

The government in the *Virginian Hotel* case and in the *Dobson* case argued that Congress, by enacting Section 116 of the Revenue Act of 1942 specifically providing for the application of the tax benefit rule in bad debt, tax and delinquency amount recoveries, indicated that it did not "regard the tax benefit theory as any part of the revenue laws in the absence of specific provision to that effect" (See govt. brief in the *Virginian Hotel* case, p. 29). In the *Virginian Hotel* case the Court accepted that argument and being able to find no specific provision in Section 113 (b)(1)(B) providing for the tax benefit rule, the Court held that rule inapplicable.

However, with respect to the identical argument as to the significance of the enactment of Section 116 made by the government in the *Dobson* case, this Court in its unanimous opinion in that case said:

> "The Government now argues that by extending legislative relief in bad debt cases Congress recognized that in the absence of specific exemption recoveries are taxable as income. We do not find that significant in the amendment. A specific statutory exemption was necessary in bad debt cases *only because the courts reversed the Tax Court and established* as matter of law a 'theoretically proper' *rule which distorted the taxpayer's income.*" (Emphasis supplied.)

The foregoing quotation from the unanimous opinion in the *Dobson* case clearly indicates that in this Court's opinion the application of the tax benefit rule does not necessarily depend upon a specific Congressional grant, and

that legislation was necessary in the bad debt cases only because the courts had misinterpreted the law and regulations—a conclusion directly opposed to the view of the majority in the *Virginian Hotel* case to the effect that the tax benefit rule would apply only where Congress had expressly made it applicable.[3]

We submit that if the majority in the *Virginian Hotel* case had considered the legislative history of Section 113 (b)(1)(B) in the light of the Court's attitude in the *Dobson* case, and had not sought to find therein a specific grant of tax benefit but rather to see whether there was anything in the legislative history to indicate an intention by Congress to deprive the taxpayer of the tax benefit rule to which he was clearly entitled under the prior law, no member of the Court would have concluded that the legislative history indicated any intention to *take away* the tax benefit rule.[4]

Counsel are aware that this Court in the opinion in the *Dobson* case states: "We are not adopting any rule of tax benefits."[5] It may be argued that the *Virginian Hotel* case

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[3] The following observation appearing in a case note in 56 Harv. L. Rev. 1164 upon this Court's decision in the *Virginian* case emphasizes the contradiction in the *Dobson* and *Virginian* decisions:

> "The holding is, however, a significant indication of the Supreme Court's unwillingness to extend the benefit doctrine to situations other than those specified by Congress."

[4] We respectfully refer the Court to pages 11 to 16 of the brief on the merits submitted by the Petitioner in the *Virginian Hotel* case and to pages 9 to 14 of the Petition for Rehearing in the *Virginian Hotel* case where the legislative history of Section 113 (b)(1)(B) is shown to contemplate tax benefit as to depreciation in excess of the allowable amount.

[5] The Court did clearly indicate in its opinion, however, that the Circuit Courts of Appeals erred in reversing the Tax Court when the Tax Court had applied the rule of tax benefit in the *Dobson* case and in the bad debt cases, and

(*Footnote continued on next page*)

is distinguishable from the *Dobson* case and bad debt cases on the theory that the *Virginian Hotel* case involves a question of law to be decided by this Court while those cases involve mixed questions of law and fact and accounting on which the decision of the Tax Court is final. The answer is simple. It is unnecessary to determine whether the *Virginian Hotel* case involves a question of law or one of those mixed questions where the decision of the Tax Court is final. In either case it is apparent from the opinion in the *Dobson* case that the *Virginian Hotel* case was wrongly decided.

If the question in the *Virginian Hotel* case is one of law, the question in the concededly analogous bad debt cases must equally be one of law, and the determination of this Court in the *Dobson* case that the bad debt cases were erroneously decided was a decision of law, requiring a similar legal decision in the *Virginian Hotel* situation. If, on the other hand, the determination in the *Dobson* opinion that the bad debt cases were erroneously decided by the Circuit Courts of Appeals was intended by this Court as a holding that the situations there involved present one of those mixed questions of law and fact and accounting as to which the Tax Court's decision is to be accepted as final, then the question in the concededly analogous depreciation situation must equally be one upon which the Tax Court's determination applying the tax benefit rule should likewise be accepted

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this Court clearly indicated its opinion that the Tax Court's decision in the bad debt cases had been correct.

Moreover, since the decision of this Court in the *Dobson* cases, several tax benefit cases have been decided by the Tax Court in favor of the taxpayer on the authority of this Court's decision. *Gibson* v. *Commissioner*, Dkt. #111781, memo. op. 12/31/43 (refund on bank stock assessment paid and deducted without full tax benefit); *Morris* v. *Commissioner*, Dkt. #112279, memo. op. 1/3/44 (payment on account of partnership contribution which had previously been written off as a loss without full tax benefit); *Watson Est.*, Dkt. Nos. 110399, 111288, memo. op. 1/4/44 (also involved refund on bank stock assessment).

as final and the decision of the Circuit Court of Appeals reversing the Tax Court's decision in the *Virginian Hotel* situation therefore should have been reversed.

We believe that anyone will concede that the result reached in the *Virginian Hotel* case is inequitable. The Circuit Court of Appeals in deciding the case so stated.[6] There seems to be no reason why the tax benefit rule should not apply in this situation equally as well as in the bad debt and the *Dobson* and other similar situations. It seems entirely reasonable to believe that Congress will, if necessary, amend the statute to make it clear that it did not by the provisions of Section 113 (b)(1)(B) intend to deprive a taxpayer in the situation of the *Virginian Hotel* of the application of the tax benefit rule. But as this Court well knows, the revenue acts are already becoming so complicated that they cannot be understood and, as this Court has indicated in the *Dobson* case, it certainly will not wish to impose upon Congress the necessity of further corrective legislation where a consistent interpretation of the present laws will make further legislation unnecessary.[7]

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[6] In deciding the *Virginian Hotel* case the Circuit Court of Appeals said:

> "The method used by the Commissioner for computing depreciation through the remaining years of useful life of the property seems to involve hardship in view of the fact that the taxpayer has received but little tax benefit for the depreciation allowed, and the rates for the remainder of the useful life are less than they would have been if the rates and useful life had been correctly computed in the first instance. The answer is that the remedy is with Congress and not the courts or the executive."

[7] The difficulties and the complexities attendant upon covering matters of this sort by law and regulations, instead of by proper administrative handling of individual cases under which the tax benefit rule would rarely, if ever, present any difficulty, will be clearly seen from an examination of Regulations 103, Sec. 19.22 (b) (12)—1 as added by T. D. 5288, 1943-15 Int. Rev. Bull. 2.

It is believed that the decisions in the *Virginian Hotel* case and the *Dobson* case, if both are permitted to stand unchanged, will result in untold confusion with reference to this court's view as to the application of the tax benefit rule and as to the scope of review by Circuit Courts of Appeals of decisions of the Tax Court.

Respectfully submitted,

F. G. Davidson, Jr.
Theodore L. Harrison
J. Donald Rawlings
W. A. Sutherland
Amici Curiae

March, 1944.

SUPREME COURT OF THE UNITED STATES.

Nos. 130-133.—October Term, 1943.

Bessie P. Douglas, Petitioner, 130 vs. Commissioner of Internal Revenue. Bessie P. Douglas, Petitioner, 131 vs. Commissioner of Internal Revenue. Estate of Charles H. Robinson, Northwestern National Bank and Trust Company of Minneapolis, Jessie P. Robinson, et al., etc., Petitioners, 132 vs. Commissioner of Internal Revenue. Bernice B. Dalrymple, Petitioner, 133 vs. Commissioner of Internal Revenue.	On Writs of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[May 15, 1944.]

Mr. Justice Reed delivered the opinion of the Court.

The Commissioner of Internal Revenue assessed income tax deficiencies against the petitioners for the year 1937, because of their failure to include in income for that year sums required to be reported by the terms of Article 23(m)-10(e) of Treasury Regulations 94, issued pursuant to Section 23(m), Revenue Act of 1936. The facts were not in dispute. Bessie P. Douglas, the petitioner in Nos. 130 and 131, was in 1929 co-owner with Adeline R. Morse, Charles H. Robinson, and Irene B. Robinson Cirkler of an iron ore mine in St. Louis County, Minnesota, known as the Pettit mine. The petitioners in No. 132 are the executors of the estate of Charles H. Robinson, and the petitioner in No. 133 is the transferee of the assets of the estate of Irene B. Robinson Cirkler, deceased.[1] In 1929 its co-owners leased this mine to the Republic Steel Corporation. The lease, as amended in 1933, ran

[1] Bessie P. Douglas owned a one-half interest; each of the other co-tenants owned a one-sixth interest. The executor of the estate of Adeline R. Morse did not appeal from an adverse decision of the Board of Tax Appeals.

for a term of thirty years, but the lessee was given the power to cancel it at the end of eight years. The lessee undertook to pay a royalty of 40 cents a ton for the ore removed and guaranteed minimum royalties of $20,000 a year for the first five years and $40,000 a year thereafter, subject after five years to the payment of $60,000 a year as a minimum during the time it failed to remove certain water from the mine. In case the guarantee required the lessee to pay in any one year for more ore than it actually removed, it was entitled to have the excess payment applied against removals in later years. The lessee paid the minimum royalties each year, but it removed no ore at all, and as of July 1, 1937, at the end of the eight year period, it surrendered the lease. Each lessor took a proper depletion deduction in the respective years the royalties were paid, 1929 to 1936, inclusive. In the year 1933, Bessie P. Douglas claimed a depletion deduction of $4958.05, but since she had sustained a net loss of $13,947.51, this deduction did not affect her tax liability. The Commissioner required all of the deductions to be taxed as income in 1937. The Board of Tax Appeals affirmed his conclusion, except as to the 1933 deductions by Bessie P. Douglas, which was reversed. 46 B. T. A. 943. Upon appeals by the taxpayers and, in No. 131, by the Commissioner, the Circuit Court of Appeals upheld the original assessments. 134 F. 2d 762. We granted petitions for writs of certiorari to settle a question reserved by our decision in *Herring v. Commissioner*, 293 U. S. 322, 328, as to cost depletion, and to consider an issue similar to that involved in *Dobson* v. *Commissioner*, 320 U. S. 489.

The Revenue Act of 1913, Section II(G)(b), granted a deduction for depletion based solely on actual production and "not to exceed 5 per centum of the gross value at the mine of the output for the year." Under this Act, advance royalties were taxed without deduction for depletion. In 1916 Congress removed the 5% ceiling, but the deduction was still limited to the year of actual extraction. Revenue Act of 1916, Section 5(a) Eighth (b). The relevant parts of the depletion section reached substantially their present form in the Revenue Act of 1918, which, like the 1916 Act, authorized "a reasonable allowance for depletion . . . under rules and regulations to be prescribed" with the approval of the Secretary of the Treasury; but the 1918 Act no longer limited the allowance to the product actually mined and sold during the year. The section now reads as follows:

"SEC. 23. Deductions from Gross Income.

"In computing net income there shall be allowed as deductions:

. . . . . .

"(m) Depletion.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. . . . ." Revenue Act of 1936, c. 690, 49 Stat. 1648, 1658-60.

From the beginning of income taxation, as now, the regulations covered the conventional situations of payments for ores as mined and made provision for depletion measured by the volume actually extracted. The 1918 Act permitted the new regulations, Regulations 45, Article 215(c), to provide for the first time a deduction in the year of receipt of advance royalties of a depletion allowance calculated on the unit value of the mineral in place. This met a frequently recurring variation from the normal lease. As a corollary the regulations required that in case a lease was surrendered before the lessee had extracted all the ore for which advance royalties had been paid, a sum equal to the depletion allowance previously granted on such ore should be taxed as income in the year of the surrender of the lease. The bonus or advanced royalty regulations have remained practically unchanged since 1919.[2] The subsections applicable to prepaid royalties are as follows:

"ART. 23(m)-10. Depletion—Adjustments of accounts based on bonus or advanced royalty.

. . . . . .

"(b) If the owner has leased a mineral property for a term of years with a requirement in the lease that the lessee shall extract

[2] In addition to Regulations 45, Article 215, the provision appeared thereafter in Regulations 62, Article 215, issued under Section 214(a) of the Revenue Act of 1921; Regulations 65 and 69, Article 216, issued under Section 214(a) of the Revenue Acts of 1924 and 1926; Regulations 74, Article 236, issued under Section 23(l) of the Revenue Act of 1928; Regulations 77, Article 230, issued under Section 23(l) of the Revenue Act of 1932; Regulations 86 and 94, Article 23(m)-10, issued under Section 23(m) of the Revenue Acts of 1934 and 1936. They have remained unchanged under the Code, Regulations 111, Section 29.23(m)-10.

and pay for, annually, a specified number of tons, or other agreed units of measurement, of such mineral, or shall pay, annually, a specified sum of money which shall be applied in payment of the purchase price or royalty per unit of such mineral whenever the same shall thereafter be extracted and removed from the leased premises, an amount equal to that part of the basis for depletion allocable to the number of units so paid for in advance of extraction will constitute an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by the lessor shall be claimed or allowed in any subsequent year on account of the extraction or removal in such year of any mineral so paid for in advance and for which deduction has once been made.

"(c) If for any reason any such mineral lease expires or terminates or is abandoned before the mineral which has been paid for in advance has been extracted and removed, the lessor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned." Treasury Regulations 94, promulgated under the Revenue Act of 1936.

The deficiency here assessed falls squarely under the subsections. Their validity is therefore the decisive issue. In our opinion the regulations are valid.

Since the revenue acts have not forbidden recognition of bonus or advanced royalties as a basis for the calculation of appropriate depletion, the provision of the regulations for a depletion offset against their receipt is within the broad rule-making delegation of Section 23(m). Royalty or bonus payments in advance of actual extraction of minerals are, like sales after severance or royalty payments on actual production, gross income and not a recovery of capital. *Stratton's Independence* v. *Howbert*, 231 U. S. 399, 418; *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103, 114; *Burnet* v. *Harmel*, 287 U. S. 103; *Herring* v. *Commissioner*, 293 U. S. 322, 324. Cf. *Anderson* v. *Helvering*, 310 U. S. 404, 407-8. Any deduction from this income for depletion, of course, may be allowed upon such terms as Congress may deem advisable. *Helvering* v. *Bankline Oil Co.*, 303 U. S. 362, 366; *United States* v. *Ludey*, 274 U. S. 295, 302. Depletion based on cost is like depreciation. Congress has allowed a recovery of the capital invested in a mine but, except in discovery or percentage deple-

tion in special instances which are not here involved, see Section 114, allowed nothing beyond that investment. Sections 23(m) and (n), 113, 114; 49 Stat. 1648, 1660, 1682-1687. Deduction is allowed for the exhaustion of the property—the ore mass. *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364, 370. It may be in step with extraction, where extraction and sale synchronize with payments for the ore or the deduction may be allowed against advance payments of royalties or bonus. The theory of depletion is the same in both cases. In either situation, the depletion deduction is allowed in the ore extracted or expected to be extracted. Regulations 45, Art. 23(m)-2 and -10(a) and (b). Thus the mine owner under Article 23(m)-10 is compensated for the use of his mineral reserves in the production of gross income.

By the 1919 Regulations, the plan of restoring the sum of depletion deductions to capital and carrying a corresponding amount to income in the year of the termination of a lease without production was adopted instead of a permanent reduction of basis or a restoration of the depletion deductions to income for the years in which they were deducted. The Act—Sec. 23(m)—did not specifically authorize this handling of unrealized depletion. By the terms of the section a reasonable allowance for depletion was required, "according to the peculiar conditions in each case." As Congress obviously could not foresee the multifarious circumstances which would involve questions of depletion, it delegated to the Commissioner the duty of making the regulations. Article 23(m)-10(e) was developed to take care of the type of situation where because of a lease's cancellation without extraction, the reason for allowing depletion disappeared. As no diminution occurred in the ore mass, no depletion was appropriate. Congress has enacted numerous revenue acts since that time and has seen no occasion to change the statutory delegation of authority to the Commissioner of Internal Revenue which is the basis of this long standing regulation. This evidences that subsections 23(m)-10(b) and (c) are within the rule-making authority which was intended to be granted the Commissioner. *National Lead Co.* v. *United States*, 252 U. S. 140, 145-46; *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299, 307.

As no depletion of the ore mass occurred or can occur under the lease which produced the gross income, the issue is not whether the regulation gives a reasonable allowance for depletion when prepaid royalties are involved. That issue has been decided in

favor of the validity of such allowances in other cases. *Herring* v. *Commissioner*, 293 U. S. 322; *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299. The problem here is the validity of Article 23(m)-10(e) when the depletion for which a deduction has been previously allowed fails in the manner anticipated as a possibility at the time of deduction.

A. Petitioners attack the validity of the regulation on the ground that the restoration of the accumulated deductions to capital, i. e., the depletion basis, with a corresponding increase of the taxpayers' annual income for the year of the restoration, is contrary to the requirements of certain sections of the 1936 Act. Sections 23(m), 114(b)(1) and 113(b)(1)(B). It is unnecessary to appraise the effect in other years of the antecedents of these sections. Petitioners urge that the depletion deductions which were the untaxed portion of the royalties paid in prior years were capital recoveries in those prior years which resulted in a statutory, permanent reduction of basis which cannot be restored to basis and hence cannot be treated as income for 1937. Petitioners point to Section 23(m), page 3 *supra*, as providing for the deduction for depletion on payment of advance royalties. It is contended that Sections 114(b)(1) and 113(b)(1)(B)[3] supplement the statutory direction of 23(m) for depletion by requiring

[3] "SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(b) Basis for depletion.—

(1) GENERAL RULE.—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3) and (4) of this subsection. . . ."

"SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(b) Adjusted basis.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) GENERAL RULE.—Proper adjustment in respect of the property shall in all cases be made—

(A) for expenditures, receipts, losses, or other items, properly chargeable to capital account, including taxes and other carrying charges on unimproved and unproductive real property, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years;

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. . . ."

the permanent lowering of the basis to reflect the depletion which Section 23 offers.[4] This, of course, is a contention that depletion for advance royalties is, as a matter of statute, not necessarily and inevitably tied to extraction, actual or prospective. Summarily expressed, it is that the depletion was permanent, not conditional, and not subject to recovery when it became clear that no minerals were to be extracted.

To accept these arguments as a sound interpretation of the meaning of these provisions, however, would put into Section 23(m) of the Act of 1936 a requirement for depletion against advance royalties which the words of Section 114 do not import. We think the Government is correct in its argument that the adjustment of basis authorized by Section 113(b)(1)(A) includes a restoration of depletion to capital account (basis) under the words "or other items, properly chargeable to capital account," when the termination of the lease without extraction of ore forces the reconsideration of depletion. Consequently, we hold that Sections 23(m), 114(b)(1) and 113(b)(1)(B) do not affect the power of the Commissioner under Section 23(m) to restore to the basis the amounts previously deducted in accordance with Article 23(m)-10(b) of Regulations 94. The taxpayer who receives advance royalties receives a gross income but has no statutory right to depletion apart from actual or prospective extraction. To grant irrecoverable depletion in circumstances where cancellation of the lease occurs prior to extraction would sever depletion from extraction and, if no later extraction followed, deflect income into the capital account without any corresponding capital loss.

B. Petitioners vigorously press another argument against the validity of the regulations. This is that the separate annual instalments of untaxed royalties (prior depletion deductions), since these untaxed portions of the royalties were income for the prior years, may not be accumulated and taxed for 1937 because such treatment is fictional, distorts the 1937 income to petitioners' detriment, is unreasonable and violates Sections 23(m), 41 and 42 of the Act. The latter two sections require the computation of income, net and gross, upon the basis of an annual accounting period and the inclusion of gross income in the year received by

[4] The second sentence of Section 23(m), relating to a change of estimate as to recoverable mineral, is said to indicate a legislative intention that the basis, once reduced, is not to be restored.

the taxpayer. The applicability of all three sections depends upon whether a sum equal to depletion deductions allowed in prior years may be treated as income for 1937. Petitioners deny that this may be done and rely for the soundness of their position upon the familiar principle of annual computation of income, "as the net result of all transactions within the year." *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 365.

It is true that the advanced royalties were income to the taxpayers for the respective years in which they were received. A certain portion of each of such payments was, however, properly deducted from this income for depletion under Article 23(m)-10(b). In accordance with our position and conclusion, as set out in the paragraphs under the preceding section A of this opinion, such deductions were not finally charged to basis but were tentatively so charged, subject to the contingency that there should occur under the lease an actual extraction of mineral units which would be allocable to the deduction. Under subsection (c) there was the further requirement that if the contingency failed, the suspended sums should fall into income in the year that the failure was manifested by the termination of the lease. It seems entirely proper for the Commissioner not only to provide for a reasonable allowance for depletion when advance royalties are paid but also to provide for the situation when the expected depletion did not take place. Annual deductions were made by the taxpayer from his income. These were allowed to compensate for the exhaustion of capital. An event occurred in 1937, the termination of the lease, which restored the deductions for depletion to income. This requirement is, we think, within the delegation of authority to the Commissioner. The power delegated to him to make regulations for depletion must necessarily include power to provide for situations where the anticipated depletion of the mineral mass does not occur.

The manner in which the Commissioner exercised that power by attributing the sums restored to basis to the 1937 income, rather than to the years 1929 to 1936, is not invalid as an arbitrary penalty or an improper attribution under the theory of an annual period for determination of income taxes. On the termination of the lease, the lessee surrendered the right to extract without royalty the ore for which royalty had been prepaid. This surrender returned to the taxpayer in 1937 a legal right. Thereupon the tax-

payer was in position to again sell the right to extract this ore or to mine that self-same ore itself. The record does not show any valuation of this right which the lessee surrendered. The lessee paid for the right the amount attributed to the petitioners' income. Irrespective of the actual value of the right in 1937, it does not seem unfair for a general regulation to put this value on the right restored to the taxpayer in the year of its restoration. The decisions uphold the regulation. *Sneed* v. *Commissioner of Internal Revenue*, 119 F. 2d 767, 770-771; 121 F. 2d 725; *Lamont* v. *Commissioner of Internal Revenue*, 120 F. 2d 996; *Grace M. Barnett*, 39 B. T. A. 864.[5]

The restoration of the right to petitioners in 1937 is analogous to the surrender of a leasehold, improved by the lessee, to the lessor. In such a case, the value of the improvements is income to the lessor at the time of the surrender. *Helvering* v. *Bruun*, 309 U. S. 461. Cf. *Maryland Casualty Co.* v. *United States*, 251 U. S. 342.

C. The last contention of petitioners for our consideration is that where depletion deductions were taken in years when no equivalent tax benefit resulted, the amount of the deduction which resulted in no tax benefit should not be attributed to the year of the surrender of the lease. This question arises only in No. 131. The Board of Tax Appeals refused to allow the addition to the 1937 income of the taxpayer of sums which represented the amount

[5] Petitioner calls attention to Knapp v. Commissioner, 7 B. T. A. 790, and Cooper v. Commissioner, 7 B. T. A. 798, acquiesced in respectively by the Commission, Acq. VII-1 Cum. Bul. 17 and 7, June 30, 1928; Acquiescence withdrawn December 31, 1932, XI-2 Cum. Bul. 12, 14. Petitioners' point is that whatever may be the validity of the regulations, taxpayers should not have their depletion deductions, for the years when the Commissioner's acquiescence was in effect, carried to income in a later year. We agree that these decisions held invalid a regulation like Art. 23(m)-10(e) which includes in income for a taxable year deductions allowed in prior years. The effect of the Commissioner's acquiescence is uncertain. Cf. C. B. XIII-2-IV. During the period of acquiescence, the regulation continued in existence and was republished in the edition of December 1, 1931, approved February 15, 1929, of Regulations 74 under the Revenue Act of 1928, Art. 236(e). This was prior to the decision in Murphy Oil Co. v. Burnet, 287 U. S. 299, 304, decided December 5, 1932, thought by petitioner to have brought about the withdrawal of the acquiescence. Acquiescence by the Commissioner in a Tax Court ruling followed by action which is inconsistent with the withdrawal of an affected regulation is not a sufficiently definite administrative practice to justify a judicial ruling against the regulation on the strength of the acquiescence. Estate of Sanford v. Comm'r, 308 U. S. 39, 49; Higgins v. Smith, 308 U. S. 473, 478.

of deductions for depletion beyond amounts of deductions which offset income. The Circuit Court of Appeals reversed.

Upon this last point, the decision below in No. 131 is affirmed, by an equally divided court. The members of this Court who join in the dissent do not reach this question but their position on other issues results in their voting for a reversal of the entire judgment of the Circuit Court of Appeals. Two other members of this Court are of the view that in No. 131 the judgment of the Circuit Court of Appeals should be reversed and that the decision of the Board of Tax Appeals should be affirmed.

In Nos. 130, 132 and 133, the foregoing leads us to the conclusion that the regulations are valid and the judgments of the Circuit Court of Appeals are

Affirmed.

Mr. Justice JACKSON took no part in the consideration or decision of this case.

SUPREME COURT OF THE UNITED STATES.

Nos. 130-133.—October Term, 1943.

Bessie P. Douglas, Petitioner, 130 *vs.* Commissioner of Internal Revenue. Bessie P. Douglas, Petitioner, 131 *vs.* Commissioner of Internal Revenue. Estate of Charles H. Robinson, Northwestern National Bank and Trust Company of Minneapolis, et al., Petitioners, 132 *vs.* Commissioner of Internal Revenue. Bernice B. Dalrymple, Petitioner, 133 *vs.* Commissioner of Internal Revenue.	On Writs of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[May 15, 1944.]

Mr. Justice Rutledge, dissenting.

In my opinion Article 23(m)-10(c) is not a reasonable exercise of the rule-making authority conferred by Section 23. By that section Congress provided: "In computing net income there *shall be* allowed as deductions . . . *a reasonable allowance* for depletion . . . according to the peculiar conditions in each case . . . under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary." Revenue Act of 1936, 49 Stat. 1648. (Emphasis added.) Since adoption of the Revenue Act of 1918 this authority has been executed in part by Regulation 45, Article 215(c) and its successors, which permit the deduction in years when advance royalties are received. It is not urged, nor could it well be, that the deduction in such circumstances is not one comprehended by the statute. In making that mandate Congress clearly did not intend the privilege to be granted

merely on terms which would defeat its operation. Yet this, in my judgment, is exactly the effect of Article 23(m)-10(c).

In requiring that "a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned," the regulation piles up as "income" for a single year the sum of all the deductions taken in the previous ones. Wholly apart from whether in theory or in fact "income" can be said to be realized by thus piling up the deductions,[1] this requirement imposes risks and burdens upon taking the deduction heavier than any advantage to be gained from it and therefore prohibitive.

The consequences hardly could be illustrated better than by the case of Bessie P. Douglas. By taking the deduction during the eight years when she received advance royalties, 1929 to 1936 inclusive, she saved a total in taxes of about $7,000. Then her lease was canceled by the lessee. And in 1937, a year in which she received no cash return from the lease, her tax liability was increased by about $26,500 for having taken the deduction in previous years. She was thus forced to pay approximately $19,500 more in taxes than if she had never taken it.

The regulation's destructive effect bears on all who receive advance royalties, not merely on those who actually must return accumulated prior deductions as "income" in a single year. The taxpayer must take the deduction, if at all, as his royalties accrue, not later as the ore is removed. The system of annual accounting is said to require this. Cf. *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301, 306; *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359. Yet it is said also to require that the deductions be telescoped into "income" for a single year in which the returns they represent are not received, and with an effect in tax burden, by the mere fact of the aggregation, far beyond any which would be imposed if the deductions never had been authorized or taken. Hence all who receive advance royalties are faced with the choice of taking the deductions and thus risking this pyramiding of "income," against the chance the lessee will some day deplete the property, or of foregoing the deductions altogether.

It is true the taxpayer may receive an economic benefit in the release of his ore from the right of another to remove it. And

[1] Compare, e. g., 26 U. S. C. §§ 21-23, and see also 4 Mertens, Law of Federal Income Taxation (1942) § 24.64.

by the regulation's requirement that he restore to his capital account an amount equal to the sum of the accumulated deductions, he also receives a possible future tax benefit in larger deductions allowable if and when he sells or leases the minerals again. But these benefits are wholly uncertain. In fact, release of his ore from the right of removal gives him not income then realized in cash to the amount of accumulated deductions, but unsold ore in the ground which the lessee has found it unprofitable to remove although he has paid for it. The only contingency on which the taxpayer really benefits by the deductions is in the event the lessee ultimately does deplete the property. But it is difficult to believe Congress deliberately extended the opportunity for deduction to lessors whose property is not in fact depleted by the lessee's operations[2] only to authorize the Commissioner to nullify and penalize that opportunity. This the regulation does, in effect, when it imposes on one who takes the deduction the risk, on a contingency beyond his control, of having to pay in taxes several times the amount of the deductions on the happening of the contingency.

Nor is the regulation reasonably adapted to recoupment of the losses in revenue, wholly proper when incurred but which later events require to be made up. On the contrary, it perverts recoupment by pyramiding income spread in receipt over many years into "income" received in a single, entirely different one. And in a day when the tax rate mounts more often than yearly the skyrocketing effect of the process operates with wholly incalculable effect on the taxpayer, who it will be noted has no control over the contingency which brings it into play.

A regulation which would require the taxpayer to pay the taxes deducted for the prior years together with the usual interest and penalties would be harsh enough in discouragement of taking the deduction. In effect it would penalize one who rightfully takes an allowance as much as one who wrongfully does so. But, even so, this would bear some semblance of reasonable relation to recouping the losses sustained by the revenue and to allocating income to the year in which it is received. However, to amalgamate the deductions into "income" for a single year, in which none of it is actually received, is an entirely different thing. It is to make of the so-called scheme of deductions a snare for the unwary who

[2] Compare Rev. Act of 1913 § II(G)(b); Rev. Act of 1916 § 5(a)(Eighth)(b) with Rev. Act of 1918 § 234(a)(9); Rev. Act of 1936 § 23(m).

violate no law but comply with it fully; and at the same time to strain the theory of annual accounting beyond any reasonable application.

The regulation, therefore, both effectively nullifies a privilege which Congress provided the taxpayer shall have and reaches farther than any reasonable recouping provision should go. It is no answer to say deduction is a privilege which Congress need not have extended, or having extended can qualify out of existence. The question is whether Congress did, or authorized the Commissioner to do, the latter. Its language, its prior treatment of this problem[3] and its treatment of a related problem in the identical section of the Revenue Act all point to the conclusion it did neither.

Other questions are raised on the record. It is unnecessary to consider them. In my opinion Congress would not have nullified its grant of the privilege to take "a reasonable allowance for depletion" by enacting Article 23(m)-10(c) to make exercising it so hazardous, capricious, and unjust in consequence.[4] That being true, I do not think authority was delegated to the Commissioner to adopt or to the Secretary to approve it. I would reverse the judgment.

Mr. Justice MURPHY joins in this opinion.

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[3] Cf. note 2 *supra*.

[4] The uncertain career of Article 23(m)-10(c), adverted to in the Court's opinion, offers no support for Congressional acquiescence in the Commissioner's position before 1932 and only doubtfully suggests it after that date. In this case the nullifying effect of the limitation upon the privilege granted prevents removal of that doubt.